Supreme Court, U.S.
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IN THE

Supreme Court of the United States

HANDLEMAN COMPANY,
Petitioner,

v.

CAPITAL FACTORS, INC., KMART CORPORATION, KNIGHT-RIDDER, INC., and IRVING PULP & PAPER, LTD.
Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

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PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

The bankruptcy court authorized Kmart to pay in full 2,327 critical vendors at the inception of its bankruptcy, including $49 million to petitioner Handleman. Respondent Capital Factors appealed the bankruptcy court's order to the district court and gave 36 parties notice of its appeal, but not Handleman or most other critical vendors. The district court reversed and held it was "not too late" for all the critical vendors (including Handleman) to return the money. In the appeal that followed to the court of appeals, Handleman intervened to contest, on jurisdiction and due process grounds, that the district court's decision applied to it. The court of appeals rejected Handleman's arguments, stating: "it is hard to see why it matters whether the district judge's resolution would have had independent effect." The court of appeals then affirmed the district court, and held that Handleman was bound by its decision and that all 2,327 critical vendors must "accept" its decision—even though they had no notice. Kmart has now sued over 1,000 critical vendors, including Handleman, to recover the money it paid them. This petition thus presents the following questions:

1. Whether a district court may reverse as to petitioner a bankruptcy court order by which it was paid $49 million when the district court never acquired personal jurisdiction over petitioner and it was not a party in the district court.

2. Whether the court of appeals violates due process by applying the reversal of a bankruptcy court order to petitioner when petitioner was not a party in the district court and had no notice of the appeal to the district court or the opportunity to participate there.

RULE 29.6 CORPORATE DISCLOSURE

Pursuant to Sup. Ct. R. 29.6, Handleman Company makes the following disclosure:

1. Parent corporations: None

2. Any publicly held company that owns more than 10% of the party's stock: None

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INTRODUCTION

The Seventh Circuit's opinion directly conflicts with the decisions of this Court that hold: (1) a district court cannot bind a person unless it has acquired jurisdiction over that person; and (2) a person must receive notice and the opportunity to be heard, as required by the Due Process Clause of the Fifth Amendment, before a district court may impair its property interests.

It is undisputed that Handleman was never a party to Capital Factor's appeal of the Critical Vendors Order from the Bankruptcy Court to the District Court. Therefore, under this Court's decisions, the District Court's reversal of the

Critical Vendors Order could not bind Handleman or impair its property interests in the $49 million it was paid.

Yet, the Seventh Circuit ignored these fundamental principles. Instead, it affirmed the Critical Vendors Order as to Handleman based on the startling proposition that it "is hard to see why it matters whether the district judge's resolution would have had independent effect." (App at 5a). The Seventh Circuit justified its ruling by contending that: (1) the hearing in the Seventh Circuit somehow cured Handleman's lack of opportunity to be heard in the District Court; (2) Handleman was at fault for not knowing about Capital Factors' appeal because it should have monitored Kmart's bankruptcy after it was paid; and (3) Handleman did not need notice of the District Court appeal and the opportunity to be heard because (unbeknownst to Kmart and Handleman) Kmart supposedly represented the interests of all critical vendors there.

This Court has repeatedly rejected each of the arguments advanced by the Seventh Circuit when they were attempted in other cases. Thus:

1. A Due Process violation is not remedied by a post-deprivation hearing in an appellate court. *See, e.g., Nelson v. Adams, USA, Inc.*, 529 U.S. 460, 466 (2000); *Armstrong v. Manzo*, 380 U.S. 545, 551-552 (1965).

2. A person is not required, as the Seventh Circuit said, to "look out for their own interests and intervene if need be" (App at 6a) when they have not received actual notice of proceedings that may affect them. *See, e.g., Martin v. Wilks*, 490 U.S. 755, 763 (1989); *City of New York v. NY, NH & RR Co.*, 344 U.S. 293 (1953).

3. The requirement for Due Process is not avoided by the argument that a party/debtor (Kmart) represented the interests of a non-party/creditor (Handleman) in the lower court, especially where the non-party never received notice or the

opportunity to be heard concerning the party's purported representation of it. *See, e.g., Ortiz v. Fibreboard Corp.*, 527 U.S. 815, 846, 848 (1999); *Mennonite Bd. of Missions v. Adams*, 462 U.S. 791 (1983).

Unless reversed, the Seventh Circuit's decision will eviscerate the constitutional rights of Handleman and the other 2,327 critical vendors who must "accept" its decision. Most assuredly, the decision will also be used as precedent by parties and courts in other unrelated bankruptcy (and even non-bankruptcy) cases to avoid the basic (and often inconvenient) requirements of jurisdiction, notice, and the opportunity to be heard that collectively form the critical foundation to our judicial system. The Seventh Circuit's decision has enormous adverse consequences, both in the Kmart bankruptcy and generally, because it holds that an appellant need give notice only to the debtor and not to other creditors who have specific individual property interests at risk.

Given these compelling circumstances, Handleman requests that the Court grant *certiorari* and reverse the Seventh Circuit. Handleman asks this Court to hold that the reversal of the Critical Vendors Order did not apply to Handleman, who was not a party in the District Court.

OPINIONS BELOW

The opinion of the Court of Appeals is reported at 359 F.3d 866 and reprinted in the Appendix ("App.") at 1a-12a. The opinion of the District Court is reported at 291 B.R. 818 and reprinted at App. 13a-23a. The order of the Bankruptcy Court (App. 24a-32a) is unreported.

JURISDICTION

The Seventh Circuit entered its decision on February 24, 2004, and issued the mandate in five of the nine consolidated appeals on February 24, 2004. A timely petition for rehearing was filed by Irving Pulp & Paper, Ltd. in the remaining four

consolidated appeals, and that petition was denied on May 6, 2004.[1] This Court has jurisdiction pursuant to 28 U.S.C. § 1254(1).

PERTINENT CONSTITUTIONAL PROVISION AND PROCEDURAL RULE

The Fifth Amendment to the Constitution reads, in relevant part: "No person shall be . . . deprived of life, liberty, or property, without due process of law." U.S. CONST. Amend. V.

Rule 8001(a) of the Federal Rules of Bankruptcy Procedure provides:

> "An appeal from a judgment, order, or decree of a bankruptcy judge . . . shall be taken by filing a notice of appeal with the clerk within the time allowed by Rule 8002. . . . The notice of appeal shall (1) conform substantially to the appropriate Official Form, (2) contain the names of all parties to the judgment, order, or decree appealed from and the names, addresses and telephone numbers of their respective attorneys, and (3) be accompanied by the prescribed fee. Each appellant shall file a sufficient number of copies of the notice of appeal to enable the clerk to comply promptly with Rule 8004."

STATEMENT OF THE CASE

A. The Proceedings In The Bankruptcy Court

1. Kmart's Bankruptcy

On January 22, 2002, Kmart Corporation and its affiliates ("Kmart") filed a voluntary petition for reorganization pursuant to Chapter 11 of the United States Bankruptcy Code

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[1] Knight-Ridder, Inc., a party to the Seventh Circuit appeal, is filing a Petition for Writ of Certiorari at the same time with respect to the Seventh Circuit's resolution of the substantive bankruptcy issues.

in the United States Bankruptcy Court for the Northern District of Illinois. Kmart was the largest retailer to ever file bankruptcy, with more than $10 billion in debt and over 47,000 creditors.

On the first day of its bankruptcy, Kmart filed a Consolidated List of Creditors Holding 50 Largest Unsecured Claims ("Largest Creditors List"). This document identified Handleman as Kmart's 10th largest unsecured creditor, and gave detailed Handleman contact information. (App at 49a-58a).

2. The Critical Vendors Order

On the first day of its bankruptcy, Kmart also filed its Critical Vendors Motion, which sought authority to pay "the prepetition claims of certain critical vendors that are essential to the uninterrupted functioning of the Debtors' business operations."[2] (Seventh Circuit Joint Appendix ("JA") 112). Handleman was one of just two critical vendors that Kmart named in its motion. All critical vendors, other than Handleman and Fleming Companies, were identified only by category (e.g., "egg vendors"). (JA 120-21).

On January 25, 2002, after hearing testimony, the Bankruptcy Court granted Kmart's motion and entered its Critical Vendors Order that authorized Kmart:

> "in the reasonable exercise of [its] business judgment, to pay all, a portion or none of the prepetition claims . . . of the following Critical Vendors: ~~(a)~~ Fleming Companies, Inc.; (b) ***Handleman Company***; (c) vendors who supply eggs and dairy and (d) certain . . . vendors who supply goods and services related to [Kmart's] advertising program." (App. 25a (emphasis added)).

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[2] Motions to pay critical vendors arise with some frequency in Chapter 11 cases in circumstances where the debtor is not able to successfully reorganize unless certain critical vendors continue to supply goods to the debtor.

Once again, the Critical Vendors Order specifically identified Handleman by name.

3. Kmart Pays Handleman $49 Million

On February 1, 2002, Kmart paid Handleman $49 million pursuant to the authority granted it by the Critical Vendors Order. (JA 10-11, 384-85). In exchange for this payment, as required by the Critical Vendors Order, Handleman agreed to extend additional post-petition credit to Kmart, to supply critical goods and services during Kmart's bankruptcy case, and to forgo its reclamation or lien claims against Kmart.[3] (App. 29a-32a). In total, Kmart made payments to 2,327 critical vendors. (App. 6a).

4. Capital Factors' Notice of Appeal

On February 1, 2002, one creditor named Capital Factors, Inc. ("Capital Factors") filed in the Bankruptcy Court its Notice of Appeal to the District Court from the Critical Vendors Order.[4] (App. 33a). No other creditor appealed the Critical Vendors Order.

Fed. R. Bankr. P. 8001(a) mandates that notices of appeal from the bankruptcy court to the district court "shall . . . contain the names of all parties to the judgment, order, or decree appealed from." In addition, in the Kmart case, the Bankruptcy Court had issued an "Order . . . Establishing . . . Certain Notice, Case Management And Administrative Procedures" (the "Notice Procedures Order") that mandated

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[3] The Bankruptcy Code at 11 U.S.C. § 546(c)(2) recognizes a seller's statutory or common law right to reclaim goods sold while the debtor was insolvent. The bankruptcy court cannot deny a valid reclamation claim unless it grants the seller a lien or an administrative expense claim under 11 U.S.C. § 503(b).

[4] The District Court had subject matter jurisdiction pursuant to 28 U.S.C. §158(a).

that "[a]ll filings shall be served on any entity with a particularized interest in the subject of the filing." (App.41a).

Nevertheless, appellant Capital Factors did not name Handleman in its Notice of Appeal as a party. Instead, Capital Factors identified only 36 persons as parties to its appeal. (App at 33a-38a). Capital Factors chose not to name Handleman even though Handleman was specifically identified in both the Critical Vendors Order and the Critical Vendors Motion as having a "particularized interest" in the matter, and its contact information was readily available from the Largest Creditors List.

The clerk of the Bankruptcy Court served Capital Factors' Notice of Appeal on the 36 parties it had identified. Fed. R. Bankr. P. 8004. Because Capital Factors did not identify Handleman in its Notice of Appeal or comply with the Notice Procedures Order, Handleman was not served with Capital Factors' Notice of Appeal.

B. The Proceedings In The District Court

1. The Appeal Briefs In The District Court Focused On Whether The Critical Vendors Order Should Be Reversed As To Handleman

Capital Factor's brief in the District Court expressly discussed why, in its view, Handleman should not be treated as a critical vendor. Kmart's brief likewise specifically focused on Handleman and explained why it was a critical vendor. Thus, Handleman's "fate" was being argued by both sides without Handleman being notified or aware of it.

2. The District Court Was Unaware That Handleman Had Not Received Notice

The District Court specifically asked Capital Factors whether the critical vendors were "entitled to be heard" in connection with its appeal. In response, Capital Factors led

the District Court to believe that Capital Factors had notified all critical vendors that it knew about. (JA 41). This was not true, as Capital Factors knew Handleman's identity and that it had not been served with notice of Capital Factors' appeal. Thus, the District Court was concerned about whether notice had been given, but was unaware that Handleman had not received notice of Capital Factors' appeal.

3. Handleman Was Unaware Of The District Court Proceedings

Handleman was unaware of the District Court proceedings and did not know that Capital Factors had appealed the Critical Vendors Order or that the $49 million it had been paid was at risk. (JA 11).

4. The District Court's Decision

On April 8, 2003, "[a] little more than 14 months [after Capital Factors filed its Notice of Appeal], after all of the critical-vendors had been paid and as Kmart's plan of reorganization was on the verge of approval, [the] District [Court] reversed the order authorizing payment" to the critical vendors. (App. 3a). The District Court also held that it was "not too late to order that the monies be returned" to Kmart. (App. 21a).

5. Handleman Learns Of The District Court Proceedings

On April 10, 2003, Handleman learned from a third party that the Critical Vendors Order had been appealed to and reversed by the District Court. (JA 11).

C. The Proceedings In The Bankruptcy Court After The District Court's Opinion

1. The Amended Plan

Under its proposed First Amended Plan of Reorganization (the "Original Plan"), Kmart expressly waived any right to

recover critical vendor payments from the recipients. (JA 344-45 at art. 7.14). Kmart's creditors overwhelmingly approved the Original Plan.

However, on April 10, 2003—just two days after the District Court's critical vendors decision—Kmart proposed an amendment to the Original Plan (the "Amended Plan"). Under the proposed Amended Plan, Kmart (i) rescinded its waiver and (ii) was authorized to sue to recover all the payments it made pursuant to the Critical Vendors Order. (JA 368-369, 375 ¶ 54(af)). The Amended Plan also provided that all recovered critical vendor payments be paid to the *reorganized Kmart* where they would, in effect, provide additional working capital for the reorganized venture. (JA 343).

On April 23, 2003, the Bankruptcy Court, without another vote of the creditors, confirmed Kmart's Amended Plan that authorized the *reorganized Kmart* to recover the critical vendor payments for itself. (JA 368-69, 375).

Under the Amended Plan, creditors received stock in the reorganized Kmart allocated *pro rata* based on the amount of their allowed claims. (JA 378-79 at arts. 1.152, 5.5). Kmart has implemented its Amended Plan and the creditors have largely received their stock.

However, the Amended Plan made no provision for the claim of any critical vendor who is forced to return the critical vendor payment it received—and the deadline for filing pre-petition proofs of claim by these unsecured creditors expired long ago on July 31, 2002. (JA 377 at art. 1.15).

Handleman never filed a pre-petition proof of claim because it already had been paid its $49 million and did not know of Capital Factors' appeal. Had Handleman not received its $49 million critical vendor payment, it would have: filed a prepetition proof of claim (before the time to do so

expired); likely been a member of the unsecured creditors' committee; helped shape Kmart's reorganization plan; and received shares in the reorganized Kmart that have since tripled in value.[5]

2. Kmart Sues Handleman For The $49 Million

On June 24, 2003, Kmart sued Handleman in the bankruptcy court in an adversary proceeding to recover the $49 million it paid.[6] Kmart issued a press release when it filed suit stating: "Kmart does not believe that any defenses that may be asserted by Handleman will prevent a recovery of money by Kmart."[7]

D. The Proceedings In The Seventh Circuit

On April 10, 2003, Kmart appealed the District Court's reversal of the Critical Vendors Order to the United States Court of Appeals for the Seventh Circuit.[8] On May 1, 2003, Handleman filed a motion to intervene in the appeal arguing: its rights had been violated by the District Court deciding its fate without notice to Handleman or an opportunity for it to be heard; and its interests were not represented in the appeal because Kmart's interests were clearly adverse to Handleman.

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[5] This Court may take judicial notice of the fact that the stock of the reorganized Kmart began trading on April 30, 2003 under the symbol KMRT at an initial price of $15.00 per share and closed at a price of $44.30 per share on May 14, 2004, a 295% increase. Fed. R. Evid. 201.

[6] *See* JA 413-418 (*Kmart Corporation v. Handleman Company,* Complaint Against Handleman Company to Avoid Transfer of Property and for Recovery, Adv. Proc. #03A02130 (Bankr. N.D. Ill.).

[7] This press release may be found at www.kmartcorp.com/corp/story/pressrelease/news/pr030630.stm.

[8] The Seventh Circuit had subject matter jurisdiction pursuant to 28 U.S.C. §158(d).

The next day, the Seventh Circuit granted Handleman's intervention motion.[9]

On February 24, 2004, the Seventh Circuit affirmed the District Court's reversal of the Critical Vendors Order. The Seventh Circuit's opinion did not directly address Handleman's argument that the District Court lacked jurisdiction over it. The Seventh Circuit instead focused on and rejected Handleman's Due Process arguments.

The Seventh Circuit offered three reasons why Handleman's omission from the District Court proceedings did not violate the Due Process Clause. First, the Circuit Court concluded that, in light of Handleman's intervention in the Seventh Circuit appeal, it "will be bound by *our* decision, so it is hard to see why it matters whether the district judge's resolution would have had independent effect." (App. 5a) (emphasis in original). Second, the court faulted Handleman for not discovering Capital Factors' appeal on its own, because "creditors must look out for their own interests and intervene if need be—as Handleman could have done had it devoted to these proceedings the care that a $49 million stake warrants." (App. 6a). Third, it held that "Kmart vigorously represented the interests of Handleman and the other vendors Kmart deemed 'critical'" and, therefore, Capital Factors only needed to give Kmart notice of its appeal. In effect, the Seventh Circuit held that Capital Factors gave more notice than was required when it notified 35 other parties (in addition to Kmart) of its appeal.

The Seventh Circuit also concluded that, "[a]s a party before this Court, Handleman will not be allowed to contest matters resolved here." (App. 6a). In fact, the Seventh Circuit emphasized that "even the 2,327 critical vendors that are

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[9] At the time Handleman intervened, there were five consolidated appeals. Irving Pulp & Paper, Ltd. later filed four additional notices of appeal that were consolidated with the earlier five.

not parties in this court must accept the precedential effect of our decision" in any subsequent adversary proceeding against them to recover the payments they received. (App. 6a).

E. The Proceedings In The Bankruptcy Court After The Seventh Circuit's Decision

Following the Seventh Circuit's decision, Kmart proceeded with adversary proceedings in the Bankruptcy Court against more than 1,000 critical vendors to recover the critical vendor payments made to them. The Seventh Circuit's decision mandates that the critical vendors "accept" the invalidity of the Critical Vendors Order in each of these suits.[10]

REASONS FOR GRANTING THE PETITION

I. THE DISTRICT COURT HAD NO PERSONAL JURISDICTION OVER HANDLEMAN AND ITS REVERSAL OF THE CRITICAL VENDORS ORDER MAY NOT BE APPLIED TO HANDLEMAN

It is fundamental that a court cannot bind a person to a decree or judgment unless it first acquires personal jurisdiction over them. *Martin v. Wilks*, 490 U.S. 755, 761, 763 (1989), makes this basic point:

> "All agree that it is a principle of general application in Anglo-American jurisprudence that one is not bound by a judgment *in personam* in a litigation in which he is not designated as a party or to which he has not been made a party by service of process.
>
> * * * *

[10] *See* May 6, 2004 Order in Kmart's bankruptcy (Case #B202474) that identifies these cases and establishes case management procedures for them.

> Unless duly summoned to appear in a legal proceeding, a person not privy may rest assured that a judgment recovered therein will not affect his legal rights." (citations omitted).

As this Court further emphasized in *Richards v. Jefferson County*, 517 U.S. 793, 798 (1996):

> "This rule is part of our deep-rooted historic tradition that everyone should have his own day in court. As a consequence, a judgment or decree among parties to a lawsuit resolves issues as among them, but it does not conclude the rights of strangers to those proceedings." (citations omitted).

It is undisputed that Handleman was not a party to Capital Factors' appeal of the Critical Vendors Order in the District Court. Under this Court's decisions, the District Court thus did not have jurisdiction over Handleman and had no power to decide any issue that would bind Handleman with respect to the $49 million it received. The only persons bound by the District Court's decision were the 36 parties that Capital Factors named in its Notice of Appeal.

The Seventh Circuit never directly addressed Handleman's jurisdiction argument. Instead, it concluded that it did not matter whether the District Court's decision had independent effect because Handleman had intervened in the Seventh Circuit. (App at 5a).

Contrary to what the Seventh Circuit said, it is enormously important whether the District Court had jurisdiction over Handleman. This Court's jurisdiction decisions have repeatedly held that a decision on the merits cannot stand and the slate must be wiped clean when the lower court did not have jurisdiction. *Helicopteros Nacionales De Colombia, S.A. v. Hall*, 466 U.S. 408 (1984), illustrates the point. There, after the defendant's dismissal motion for lack of personal jurisdiction was denied, it actively defended, but lost at trial both on the plaintiff's claim and its cross-claim against another party.

The defendant then appealed the judgment against it, claiming the trial court lacked personal jurisdiction over it. This Court agreed, reversed the judgment against the defendant, and eliminated the decision on the merits against it. *See Peralta v. Heights Medical Center, Inc.*, 485 U.S. 80, 87 (1988)("wiping the slate clean" is only appropriate remedy); *Armstrong v Manzo*, 380 U.S. 545, 552 (1965) (same).[11]

Handleman now asks this Court to "wipe[] the slate clean" as to it (and the other 2,327 critical vendors who never received notice). The District Court had no jurisdiction over Handleman and, as a result, the Seventh Circuit could not retroactively bind Handleman to the reversal of the Critical Vendors Order.

II. HANDLEMAN'S DUE PROCESS RIGHTS WERE VIOLATED

Handleman intervened in the Seventh Circuit to point out that what transpired in the District Court could not bind it. The Seventh Circuit brushed off Handleman's arguments and held, in effect, that Handleman's challenge to what happened in the District Court bound it to what the District Court did when Handleman was not there. The Seventh Circuit's decision cannot be squared with the basic requirements of Due Process—notice and opportunity to be heard—and directly conflicts with this Court's decisions.

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[11] *Torres v. Oakland Scavenger Co.*, 487 U.S. 312 (1988), makes a similar point in the opposite situation. There, a group of plaintiffs appealed an unfavorable decision, but failed to name one of them in their notice of appeal. The Court of Appeals reversed, but the plaintiff who was not named in the appeal did not get the benefit of the reversal. Under the rules then in effect, the failure to name the one plaintiff made him a non-party to the appeal and the adverse lower court decision was final and binding as to him. Here, as in *Torres*, the reversal of the Critical Vendors Order should not be applied to Handleman because it was not a party to the District Court appeal. *See Becker v Montgomery*, 532 U.S. 757, 767 (2001)(endorsing the continuing vitality of *Torres*' logic).

A. Handleman's Due Process Rights Were Violated In The District Court

1. *Handleman Was Denied Notice And The Opportunity To Be Heard*

It is undisputed that Handleman did not receive notice of Capital Factors' appeal and did not learn of the appeal until after the District Court reversed the Critical Vendors Order.

Unquestionably, Handleman's property interests were at stake in the District Court proceedings. After all, Capital Factors was attempting to invalidate the Critical Vendors Order and obtain the return of all critical vendor payments, including the $49 million paid Handleman. Handleman's property interest in retaining the $49 million was clear and enormous. *Board of Regents of State Colleges v. Roth*, 408 U.S. 564, 571-2 (1972) ("property interests" include and "extend well beyond actual ownership of real estate, chattels, or money"); *Tulsa Professional Collection Services, Inc. v. Pope*, 485 U.S. 478, 485 (1988) (an intangible interest, including an unsecured claim, constitutes a protected property interest); *Connecticut v. Doehr*, 501 U.S. 1, 12 (1991) (Due Process protections apply to impairment of property rights); *Mennonite Bd. Of Missions v. Adams*, 462 U.S.791, 798-99 (1983) (finding Due Process violation where mortgagee were not notified of tax sale, even though sale would only diminish, not extinguish, its mortgage interest); *Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306, 313 (1950) (proceeding which diminishes property interest "must measure up to the standards of due process").

"[I]ndividuals whose property interests are at stake are entitled to notice and an opportunity to be heard." *Dusenbery v. United States*, 534 U.S. 161, 167 (2002) (citations omitted). *See Lachance v. Erickson*, 522 U.S. 262, 266 (1998) ("The core of due process is the right to notice and a meaningful opportunity to be heard"). Therefore, the District Court could

not impair Handleman's right to retain its $49 million unless Handleman was first afforded the notice and opportunity to be heard that Due Process requires. *Roth*, 408 U.S. at 571-72 (ownership is the quintessential property right).

In the seminal case of *Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306 (1950), this Court established what Due Process requires:

> "[T]here can be no doubt that at a minimum [the Due Process Clause] require[s] that deprivation of life, liberty or property by adjudication be preceded by notice and opportunity for hearing appropriate to the nature of the case. . . . An elementary and fundamental requirement of due process in any proceeding which is to be accorded finality is notice reasonably calculated, under all the circumstances, to apprise interested parties of the action and afford them an opportunity to present objections." 339 U.S. at 313-14 (citations omitted).

In *Mullane*, the Court held that Due Process was not satisfied through notice by publication when a party's name and address were known. As the Court explained, "[w]here the names and post office addresses of those affected by a proceeding are at hand, the reasons disappear for resort to means less likely than the mails to apprise them of its pendency." *Id.* at 318.

"Since *Mullane* was decided, [this Court has] regularly turned to it when confronted with questions regarding the adequacy of the method used to give notice." *Dusenberry*, 534 U.S. at 167-68. *See Mennonite*, 462 U.S. at 800 ("This Court has adhered unwaveringly to the principle announced in *Mullane*").

Applying these principles in *City of New York v. New York, N.H. & H. R.R. Co.*, 344 U.S. 293 (1953), this Court, in the bankruptcy context, held that a creditor whose identity and address were known was not bound by a claims bar date

where that creditor was not specifically given notice of the bar date.

In short, long-established principles and fundamental Due Process required that Handleman (whose identity and contact information were contained in the Largest Creditors List and the Critical Vendors Order) be given notice of Capital Factors' appeal to the District Court before Handleman's property right to $49 million could be impaired by the District Court. Yet, in violation of Handleman's Due Process rights, Handleman was not given notice even though Capital Factors knew Handleman's name and address.

2. *The District Court's Decision Was Void As To Handleman*

"A judgment rendered in violation of due process is void." *World-Wide Volkswagen Corp. v. Woodson*, 444 U.S. 286, 291 (1980). In such a circumstance, the judgment must be vacated to "restore[] the petitioner to the position he would have occupied had due process of law been accorded to him in the first place." *Armstrong v. Manzo*, 380 U.S. at 551-52 (1965). *See Peralta v. Heights Medical Center, Inc.*, 485 U.S. at 86-87 (slate must be wiped clean); *Parklane Hosiery Co., Inc. v. Shore*, 439 U.S. 322, 327 n.7 (1979) ("It is a violation of due process for a judgment to be binding on a litigant who was not a party or a privy and therefore has never had an opportunity to be heard").

As to Handleman, therefore, the Seventh Circuit should have vacated the District Court's judgment and returned Handleman to the position it would have occupied if its Due Process rights had been accorded it in the first place.[12]

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[12] The District Court did have jurisdiction over the 36 parties that were given notice of Capital Factors' appeal to the District Court and, as to them, the Seventh Circuit could decide the merits of the Critical Vendors Order.

B. The Seventh Circuit's Reasons For Affirming The District Court Judgment As To Handleman Are Directly Contrary To Numerous Decisions Of This Court

1. *The Due Process Violation Was Not Cured When Handleman Had A Hearing In The Seventh Circuit*

The Seventh Circuit saw no problem with Handleman's Due Process rights being skipped at the District Court stage, apparently because it concluded that any violation was cured by granting Handleman a hearing in the Seventh Circuit. However, this Court has rejected the notion that the skipping of a step in the judicial review process is consistent with Due Process.

A post-deprivation appellate review does not "cure" an earlier Due Process violation. *Nelson v. Adams, USA, Inc.*, 529 U.S. 460, 466 (2000) ("Appeal after judgment [that is entered in violation of Due Process] did not provide an adequate opportunity to defend against the imposition of liability"); *Fuentes v. Shevin*, 407 U.S. 67, 82 (1972) ("no later hearing . . . can undo . . . [the] due process" violation"); *Armstrong*, 380 U.S. at 552 (post-deprivation hearing does not "cure" a Due Process violation[13]; remedy is to "restore[] the petitioner to the position he would have occupied had due process of law been accorded to him in the first place").[14]

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[13] In *Armstrong*, this Court held that even the trial court could not "cure [the decree's] constitutional invalidity" by granting a hearing on a motion to set it aside, because such a motion improperly placed the burden on the victim. 380 U.S. at 550-551.

[14] One rationale for this rule stems from the benefits of the adversary system. "No better instrument has been devised for arriving at truth than to give a person in jeopardy of serious loss notice of the case against him and opportunity to meet it." *United States v. James Daniel Good Real Property*, 510 U.S. 43, 55 (1993) (quoting *Joint Anti-Fascist Refugee*

Three of this Court's more recent decisions enforce the rule that appellate review does not remedy a Due Process violation in a lower court. In *Richards v. Jefferson County*, 517 U.S. 793 (1996), for example, the plaintiffs were citizens who brought a class action to challenge a county tax ordinance levied against them. The state court barred the claim on res judicata grounds, because officials from the local government had already unsuccessfully raised the same challenges to the ordinance in a prior lawsuit. This Court unanimously reversed, citing the deeply rooted rule that all parties are entitled to their day in court. This Court:

> "beg[a]n by noting that the parties to the [prior] case failed to provide petitioners with any notice that a suit was pending which would conclusively resolve their legal rights. That failure is troubling because, as we explained in *Mullane* . . ., the right to be heard ensured by the guarantee of due process has little reality or worth unless one is informed that the matter is pending and can choose for himself whether to appear or default, acquiesce or contest." 517 U.S. at 798 (quotations omitted).

This Court's unanimous decision in *Nelson v. Adams USA, Inc.*, 529 U.S. 460 (2000) also illustrates the point. There, judgment was entered against Nelson's one-man corporation that was the sole defendant. Concerned about collectability, the plaintiff secured the district court's approval to amend the pleadings after the judgment to add Nelson individually as a defendant, and then immediately also entered judgment against him without ever giving him an opportunity to

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Comm. v. McGrath, 341 U.S. 123, 170-172 (1951) (Frankfurter, J., concurring)). "Our deep-rooted historic tradition that everyone should have his own day in court draws from clear experience with the general fallibility of litigation and with the specific distortions of judgment that arise from the very identity of the parties." 18A Wright, Miller & Cooper, FED PRAC & PROC: JURIS 2D § 4449, at 346-48.

respond. Nelson appealed and the Federal Circuit affirmed, reasoning that the result would not have changed if Nelson had been provided an opportunity to be heard before judgment was entered against him. This Court reversed, finding the ultimate result irrelevant to the existence of a Due Process violation and the appropriate remedy:

> "[T]he Federal Circuit reasoned that nothing much turned on whether the party opposing Adams' claim for costs and fees was OCP or Nelson. * * * We neither dispute nor endorse the substance of this speculation. We say instead that judicial predictions about the outcome of hypothesized litigation cannot substitute for the actual opportunity to defend that due process affords every party against whom a claim is stated." 529 U.S. at 471.

Nelson's application to this case is clear: it is irrelevant that Handleman received a hearing in the Seventh Circuit or that the District Court might have reached the same conclusion if Handleman had participated in those proceedings. Handleman did not receive notice of the District Court proceedings and, therefore, did not receive the process it was due. The District Court's decision was void as to Handleman and, as a result, the Seventh Circuit had no power to bind Handleman to the reversal of the Critical Vendors Order.

To like effect is this Court's unanimous decision[15] in *Peralta v. Heights Medical Center, Inc.*, 485 U.S. 80 (1988). There, a default judgment was entered against a defendant who was never properly served. The state courts refused to set aside the default because the defendant had no defense to the plaintiff's claim. In reversing this Court declared:

> "The Texas courts . . . held . . . that to have the judgment set aside, appellant was required to show that he had a meritorious defense, apparently on the ground that

[15] Justice Kennedy did not participate.

> without a defense, the same judgment would again be entered on retrial and hence appellant had suffered no harm from the judgment entered without notice. But this reasoning is untenable. As appellant asserts, had he had notice of the suit, he might have impleaded the employee whose debt had been guaranteed, worked out a settlement, or paid the debt. He would also have preferred to sell his property himself in order to raise funds rather than to suffer it sold at a constable's auction.
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> * * * *
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> '[I]t is no answer to say that in his particular case due process of law would have led to the same result because he had no adequate defense upon the merits." . . . As we observed in *Armstrong v. Manzo*, *supra*, at 552, only "wip[ing] the slate clean . . . would have restored the petitioner to the position he would have occupied had due process of law been accorded to him in the first place." 485 U.S. at 85, 87.

As these cases demonstrate, only "wip[ing] the slate clean" restores Handleman to the position it would have occupied. In this case, "wip[ing] the slate" clean requires that this Court hold that the reversal of the Critical Vendors' Order did not apply to Handleman—or to any of the other critical vendors who did not get notice of Capital Factors' appeal to the District Court.

The consequences of not reversing the Seventh Circuit are enormous here. Unless reversed, the Seventh Circuit's decision will encourage Due Process violations at every level of the judicial system. Moreover, when these violations are discovered, they will be treated as mere harmless error that can be cured by an appellate court providing a hearing at which the victim of the Due Process violation has the burden of overturning the decision made in its absence without the opportunity to build a record below. Thus, under the Seventh

Circuit's decision, Due Process "rights" need not be respected and can be easily circumvented.

2. *The Seventh Circuit Wrongly Blamed Handleman For Not Discovering Capital Factors' Appeal*

The Seventh Circuit placed the blame on Handleman for not discovering Capital Factors' Notice of Appeal: "[o]ther creditors must look out for their own interests and intervene if need be—as Handleman could have done had it devoted to these proceedings the care that a $49 million stake warrants." (App. 6a). The Seventh Circuit thus concluded that it was Handleman's own fault for not knowing about Capital Factors' appeal. Once again, this conclusion cannot be squared with this Court's decisions.

In *City of New York v. NY, NH & H RR Co.*, 344 U.S. 293 (1953), this Court expressly declared that the Due Process Clause entitles creditors to reasonable notice from a bankruptcy court before they will be bound—even where they knew of the bankruptcy proceedings and did not monitor them. There, the City of New York knew that the railroad was in bankruptcy, but it did not appear in the proceedings. Only creditors who appeared were given actual notice of the bar date for filing claims. As a result, even though the railroad debtor was aware that the City of New York was a creditor, it did not give the City of New York notice of the bar date for filing its claim, and the City of New York did not otherwise monitor the proceedings to independently learn this information. The Court held the bar date did not bind New York:

> "Nor can the bar order against New York be sustained because of the city's knowledge that reorganization of the railroad was taking place in the court. The argument is that such knowledge puts a duty on creditors to inquire for themselves about possible court orders limiting the time for filing claims. But even creditors who have

> knowledge of a reorganization have a right to assume that the statutory 'reasonable notice' will be given them before their claims are forever barred." 344 U.S. at 297.

The Court has never wavered from this reasoning. *See, e.g., Mennonite Bd. of Missions*, 462 U.S. at 799 ("a party's ability to take steps to safeguard its interests does not relieve the State of its constitutional obligation" to serve notice); *Martin v. Wilks*, 490 U.S. at 763 (no duty to intervene where a party is entitled to notice and a hearing before its rights are affected); *Richards v. Jefferson County*, 517 U.S. at 798 (same).

By faulting Handleman for not monitoring the Kmart proceedings and discovering for itself Capital Factors' appeal of the Critical Vendors Order, the Seventh Circuit imposed on Handleman the precise affirmative duty that *City of New York* and this Court's other cases reject. The rule of *City of New York* is that creditors who are aware of ongoing bankruptcy proceedings have no duty to continuously monitor them for events that may affect their interests. The Due Process Clause requires that actual notice be given before rights may be impaired. The Seventh Circuit's insistence that "creditors must look out for their own interests and intervene if need be" flies in the face of this Court's decisions. *See Martin v Wilks*, 490 U.S. at 765 ("Joinder as a party, rather than knowledge of a lawsuit and opportunity to intervene, is the method by which potential parties are . . . bound by a judgment or decree").

3. *The Due Process Violation Was Not Cured By Kmart's Purported "Virtual Representation" Of Handleman In The District Court*

In contradiction to its argument that Handleman should have "look[ed] out for its own interests," the Seventh Circuit reversed course, and then made the completely opposite argument that "Kmart vigorously represented the interests of

Handleman and the other vendors Kmart deemed 'critical'" in the District Court appeal. (App. 6a). Therefore, according to the Seventh Circuit, notice to Handleman was not necessary.[16]

However, a trustee in bankruptcy does not have standing to assert the claims of individual creditors. *Caplin v. Marine Midland Grace Trust Co.*, 406 U.S. 416 (1972) (trustee has differing interests and lacks the standing to assert claim of individual creditor).

In addition, as explained in *Ortiz v. Fibreboard Corp.*, 527 U.S. 815, 846 (1999), the concept of virtual representation is an exception to the general rule that "everyone should have his own day in court." This exception has limited applicability and "the burden of justification rests on the exception." *Id.*

Virtual representation is never permitted without notice. Thus, Kmart could not represent Handleman's interests without providing notice to Handleman and affording it the opportunity to participate. *See Mullane v Central Hanover*, 339 U.S. at 315 (1950)(trustee must give notice to beneficiaries that their rights are before court).

In the class action context, where representation issues are most commonly raised, absent class members generally cannot be represented by class representatives unless they first receive the required notice and opportunity to participate. As *Ortiz* teaches:

> "[B]efore an absent class member's right of action was extinguishable due process required that the member

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[16] Capital Factor's own actions were contrary to this holding because it named 36 persons as parties in its Notice of Appeal—an action that would be unnecessary if Kmart represented all creditors. JA 271-280. Of course, if the Seventh Circuit's holding were accepted, it would mean that Capital Factors itself had no right to appeal the Critical Vendors Order (or to have challenged it in the bankruptcy court) because Kmart also represented Capital's interests as a creditor. This makes no sense.

> receive notice plus an opportunity to be heard and participate in the litigation, and . . . at a minimum . . . an absent plaintiff [must] be provided with an opportunity to remove himself from the class." 527 U.S. at 848 (quotations omitted).

The same protection must be afforded to those who are the subject of a "virtual" representation argument. But Handleman here never received notice that Kmart was purporting to represent its interests and never had the opportunity to decide whether to participate. Therefore, there can be no virtual representation here.[17]

Moreover, Kmart had no authority on appeal to represent Handleman's *individual* right to retain the $49 million it received. Even the Seventh Circuit agreed initially here that Kmart did not represent Handleman's individual interests. After all, it granted Handleman's motion to intervene that was based on Kmart's divergent interests. "It would indeed be strange procedure to declare, on one hand, that [the party] adequately represents the interests of the [nonparty] . . ., and then, on the other hand, to require intervention in order to

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[17] Kmart never even contended that it acted as Handleman's representative. The Seventh Circuit was also just mistaken (and in conflict with its own decisions) when it contended Kmart could act as Handleman's representative for its *individual* interest in retaining the $49 million it received. All creditors are supposed to receive notice of important events in a bankruptcy so that creditors can protect their individual interests and object to what the debtor intends to do. Bankruptcy Rule 2002(a)(f). The debtor in possession as trustee owes its obligations to the estate and creditors *collectively*, but it does not *and cannot* represent the interests of individual creditors. *Fisher v. Apostolou*, 155 F.3d 876, 880 (7th Cir. 1998) (trustee represents interests of creditors "as a whole" and "has no standing to bring personal claims of creditors"); *Steinberg v. Buczynski*, 40 F.3d 890, 893 (7th Cir. 1994) ("[T]he trustee . . . has no right to enforce entitlements of a creditor"); *In re Vitreous Steel Products Co.*, 911 F.2d 1223, 1231 (7th Cir. 1990) (individual creditors have interests separate and apart from the interests of the estate as a whole).

insure of this representation in fact." *Sam Fox Publishing Co., Inc. v. United States*, 366 U.S. 683, 691-92 (1961).

Clearly, Kmart and the critical vendors, including Handleman, did not have identical interests. Once Kmart secured the initial flow of goods from its critical vendors, it had no interest in defending the critical vendor payments. In fact, it had a huge interest in the reversal of the Critical Vendors Order and the recovery of these payments so they could provide additional cash flow to the *reorganized* Kmart. Thus, within days of the District Court's opinion, Kmart obtained approval for its Amended Plan whereby the *reorganized* Kmart was authorized to recover these payments for itself. It then quickly sued Handleman to recover the $49 million and announced in a press release that Handleman had no defense. It even elected not to make any oral argument to the Seventh Circuit in support of the Critical Vendors Order. After Kmart got the benefit of the Critical Vendors Order at the inception of the bankruptcy, its interests were radically different from those of the critical vendors. *See Mennonite*, 462 U.S. at 799 (even where mortgagor and mortgagee had the same interest in preserving their rights to real estate, notice to the mortgagor cannot be deemed notice to mortgagee).

A divergence of interest *at any point* in the judicial review process—even on appeal—also renders "virtual representation" inadequate for due process purposes. "[T]he Due Process Clause of course requires that the named plaintiff *at all times* adequately represent the interests of the absent class members." *Phillips Petrol. Co. v. Shutts*, 472 U.S. 797, 812 (1985) (emphasis added).

Under the circumstances, Kmart could not represent Handleman's *individual* interest in retaining the $49 million it was paid and could not represent Handleman in any context without first providing notice to Handleman and affording Handleman the opportunity to represent itself.

CONCLUSION

Handleman requests that the Court: grant *certiorari*; reverse the Seventh Circuit; and hold that the reversal of the Critical Vendors Order did not bind Handleman or the other 2,327 critical vendors who did not receive notice of Capital Factors' appeal and were not parties in the District Court.

Respectfully submitted,

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May 21, 2004

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

Nos. 03-1956, 03-1999, 03-2000, 03-2001,
03-2035, 03-2262, 03-2346, 03-2347 &, 03-2348

In the matter of: KMART CORPORATION,
Debtor-Appellant,
Additional Intervening Appellants.

KNIGHT-RIDDER, INC.; HANDLE- MAN COMPANY;
IRVING PULP & PAPER, LIMITED.

January 22, 2004, Argued.
February 24, 2004, Decided.

JUDGES: Before EASTERBROOK, MANION, and ROVNER, *Circuit Judges*.

OPINION

EASTERBROOK, *Circuit Judge*. On the first day of its bankruptcy, Kmart sought permission to pay immediately, and in full, the prepetition claims of all "critical vendors." (Technically there are 38 debtors: Kmart Corporation plus 37 of its affiliates and subsidiaries. We call them all Kmart.) The theory behind the request is that some suppliers may be unwilling to do business with a customer that is behind in payment, and, if it cannot obtain the merchandise that its own customers have come to expect, a firm such as Kmart may be unable to carry on, injuring all of its creditors. Full payment to critical-vendors thus could in principle make even the disfavored creditors better off: they may not be paid in full,

but they will receive a greater portion of their claims than they would if the critical-vendors cut off supplies and the business shut down. Putting the proposition in this way implies, however, that the debtor must *prove*, and not just allege, two things: that, but for immediate full payment, vendors *would* cease dealing; and that the business will gain enough from continued transactions with the favored vendors to provide some residual benefit to the remaining, disfavored creditors, or at least leave them no worse off.

Bankruptcy Judge Sonderby entered a critical-vendors order just as Kmart proposed it, without notifying any disfavored creditors, without receiving any pertinent evidence (the record contains only some sketchy representations by counsel plus unhelpful testimony by Kmart's CEO, who could not speak for the vendors), and without making any finding of fact that the disfavored creditors would gain or come out even. The bankruptcy court's order declared that the relief Kmart requested—open-ended permission to pay any debt to any vendor it deemed "critical" in the exercise of unilateral discretion, provided that the vendor agreed to furnish goods on "customary trade terms" for the next two years—was "in the best interests of the Debtors, their estates and their creditors". The order did not explain why, nor did it contain any legal analysis, though it did cite 11 U.S.C. § 105(a). (The bankruptcy court issued two companion orders covering international vendors and liquor vendors. Analysis of all three orders is the same, so we do not mention these two further.)

Kmart used its authority to pay in full the pre-petition debts to 2,330 suppliers, which collectively received about $300 million. This came from the $2 billion in new credit (debtor-in-possession or DIP financing) that the bankruptcy judge authorized, granting the lenders super-priority in post-petition assets and revenues. *See In re Qualitech Steel Corp.*, 276 F.3d 245 (7th Cir. 2001). Another 2,000 or so vendors were not

deemed "critical" and were not paid. They and 43,000 additional unsecured creditors eventually received about 10 [cent] on the dollar, mostly in stock of the reorganized Kmart. Capital Factors, Inc., appealed the critical-vendors order immediately after its entry on January 25, 2002. A little more than 14 months later, after all of the critical-vendors had been paid and as Kmart's plan of reorganization was on the verge of approval, District Judge Grady reversed the order authorizing payment. 291B.R. 818 (N.D. Ill. 2003). He concluded that neither § 105(a) nor a "doctrine of necessity" supports the orders.

Appellants insist that, by the time Judge Grady acted, it was too late. Money had changed hands and, we are told, cannot be refunded. But why not? Reversing preferential transfers is an ordinary feature of bankruptcy practice, often continuing under a confirmed plan of reorganization. *See Mellon Bank, N.A. v. Dick Corp.*, 351 F.3d 290 (7th Cir. 2003). If the orders in question are invalid, then the critical-vendors have received preferences that Kmart is entitled to recoup for the benefit of all creditors. Confirmation of a plan does not stop the administration of the estate, except to the extent that the plan itself so provides. Compare *In re Hovis*, 356 F.3d 820, 2004 U.S. App. LEXIS 1481, No. 02-2450 (7th Cir. Feb. 2, 2004), with *In re UNR Industries, Inc.*, 20 F.3d 766 (7th Cir. 1994). Several provisions of the Code do forbid revision of transactions completed under judicial auspices. For example, the DIP financing order, issued contemporaneously with the critical-vendors order, is sheltered by 11 U.S.C. § 364(e): "The reversal or modification on appeal of an authorization under this section to obtain credit or incur debt, or of a grant under this section of a priority or a lien, does not affect the validity of any debt so incurred, or any priority or lien so granted, to an entity that extended such credit in good faith, whether or not such entity knew of the pendency of the appeal, unless such authorization and the incurring of such debt, or the granting of such priority or lien,

were stayed pending appeal." Nothing comparable anywhere in the Code covers payments made to pre-existing, unsecured creditors, whether or not the debtor calls them "critical." Judges do not invent missing language.

Now it is true that we have recognized the existence of a long-standing doctrine, reflected in *UNR Industries*, that detrimental reliance comparable to the extension of new credit against a promise of security, or the purchase of assets in a foreclosure sale, may make it appropriate for judges to exercise such equitable discretion as they possess in order to protect those reliance interests. *See* also *In re Envirodyne Industries, Inc.*, 29 F.3d 301, 304 (7th Cir. 1994). Thus once action has been taken to distribute assets under a confirmed plan of reorganization, it would take some extraordinary event to turn back the clock. These appeals, however, do not question any distribution under Kmart's plan; to the contrary, the plan (which was confirmed after the district court's decision) provides that adversary proceedings will be filed to recover the preferences that the critical vendors have received. No one filed an appeal, which means that it is appellants in this court that now wage a collateral attack on the plan of reorganization.

Appellants say that we should recognize their reliance interests: after the order, they continued selling goods and services to Kmart (doing this was a condition of payment for pre-petition debts). Continued business relations may or may not be a form of reliance (that depends on whether the vendors otherwise would have stopped selling), but they are not *detrimental* reliance. The vendors have been paid in full for post-petition goods and services. If Kmart had become administratively insolvent, and unable to compensate the vendors for post-petition transactions, then it might make sense to permit vendors to retain payments under the critical vendors order, at least to the extent of the post-petition deficiency. Because Kmart emerged as an operating business,

however, no such question arises. The vendors have not established that any reliance interest—let alone any language in the Code—blocks future attempts to recover preferential transfers on account of prepetition debts.

Handleman Company, which received $49 million as a critical vendor, makes a different procedural objection: that the district court's order does not affect it because Capital Factors' notice of appeal did not name Handleman as an appellee. Handleman was not a "party" in the district court and, consistent with the due process clause of the *fifth amendment*, cannot be bound by the district judge's decision— or so it says. We permitted Handleman to intervene in this court. Thus it is a party today and will be bound by *our* decision, so it is hard to see why it matters whether the district judge's resolution would have had independent effect.

Notices of appeal in bankruptcy must name "all parties to the judgment, order, or decree appealed from". Fed. R. Bankr. P. 8001(a)(2). Handleman was not a "party" to the critical-vendors order; Kmart was the sole party at the time. Kmart filed an *ex parte* application that did not specify any particular creditor. It had notified only 65 creditors of its impending request, and none of these was among the 2,000 vendors to be left high and dry. The bankruptcy judge's order likewise did not identify any creditor that acquired rights, for *no* creditor acquired rights. All the order did was authorize Kmart to pay any vendor that Kmart in its discretion deemed "critical." The party that Capital Factors had to name thus was Kmart itself, and this it did. If the lack of personal notice about the proceedings before the district judge deprived Handleman of due process, then Kmart's application to the bankruptcy judge deprived about 47,000 unsecured creditors of due process! That would render the critical-vendors order void, and Handleman would be worse off—for then it would have to repay the money even if the order's entry otherwise would have been lawful. But there is no constitutional

obligation to make every creditor a party to every contested matter in the bankruptcy. As a rule, a trustee or debtor in possession represents the interests of many stakeholders. Kmart vigorously represented the interests of Handleman and the other vendors Kmart deemed "critical".

Other creditors must look out for their own interests and intervene if need be—as Handleman could have done had it devoted to these proceedings the care that a $ 49 million stake warrants. Handleman will be a party, and receive all the notice that the Constitution requires, if Kmart initiates a preference-recovery action against it. As a party in this court, Handleman will not be allowed to contest matters resolved here; even the 2,327 critical vendors that are not parties in this court must accept the precedential effect of our decision. No rule of law requires personal notice to all entities that might be affected by the precedential (as opposed to the preclusive) force of an appellate decision. Today's opinion affects thousands of "critical vendors" and other unsecured creditors; decisions by the Supreme Court may affect millions of persons. Only those persons who will be formally bound by a decision are entitled to individual notice, and then only when practical (the lesson of many a class action, see *Mirfasihi v. Fleet Mortgage Corp.*, 356 F.3d 781, 2004 U.S. App. LEXIS 1326, *14-15, No. 03-1069 (7th Cir. Jan. 29, 2004). So there was no flaw in the notice of appeal or the district judge's view that Kmart and Capital Factors were the only parties to the proceedings.

Thus we arrive at the merits. Section 105(a) allows a bankruptcy court to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of" the Code. This does not create discretion to set aside the Code's rules about priority and distribution; the power conferred by § 105(a) is one to implement rather than override. *See Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 206, 99 L. Ed. 2d 169, 108 S. Ct. 963 (1988); *In re*

Fesco Plastics Corp., 996 F.2d 152, 154 (7th Cir. 1993). Cf. *United States v. Noland*, 517 U.S. 535, 542, 134 L. Ed. 2d 748, 116 S. Ct. 1524 (1996). Every circuit that has considered the question has held that this statute does not allow a bankruptcy judge to authorize full payment of any unsecured debt, unless all unsecured creditors in the class are paid in full. *See In re Oxford Management Inc.*, 4 F.3d 1329 (5th Cir. 1993); *Official Committee of Equity Security Holders v. Mabey*, 832 F.2d 299 (4th Cir. 1987); *In re B&W Enterprises, Inc.*, 713 F.2d 534 (9th Cir. 1983). We agree with this view of § 105. "The fact that a [bankruptcy] proceeding is equitable does not give the judge a free-floating discretion to redistribute rights in accordance with his personal views of justice and fairness, however enlightened those views may be." *In re Chicago, Milwaukee, St. Paul & Pacific R.R.*, 791 F.2d 524, 528 (7th Cir. 1986).

A "doctrine of necessity" is just a fancy name for a power to depart from the Code. Although courts in the days before bankruptcy law was codified wielded power to reorder priorities and pay particular creditors in the name of "necessity"—*see Miltenberger v. Logansport Ry.*, 106 U.S. 286, 27 L. Ed. 117, 1 S. Ct. 140 (1882); *Fosdick v. Schall*, *99* U.S. 235, 25 L. Ed. 339 (1878)—today it is the Code rather than the norms of nineteenth century railroad reorganizations that must prevail. *Miltenberger* and *Fosdick* predate the first general effort at codification, the Bankruptcy Act of 1898. Today the *Bankruptcy Code of 1978* supplies the rules. Congress did not in terms scuttle old common-law doctrines, because it did not need to; the Act curtailed, and then the Code replaced, the entire apparatus. Answers to contemporary issues must be found within the Code (or legislative halls). Older doctrines may survive as glosses on ambiguous language enacted in 1978 or later, but not as freestanding entitlements to trump the text. *See, e.g., Lamie v. United States Trustee*, 157 L. Ed. 2d 1024, 124 S. Ct. 1023, 1031 (U.S. 2004); *United States v. Ron Pair Enterprises, Inc.*, 489

U.S. 235, 242-46, 103 L. Ed. 2d 290, 109 S. Ct. 1026 (1989); *Bethea v. Robert J. Adams & Associates*, 352 F.3d 1125, 1128-29 (7th Cir. 2003). *See* also *Noland* (courts lack authority to subordinate creditors that judges, as opposed to legislators, believe should be lower in the hierarchy).

So does the Code contain any grant of authority for debtors to prefer some vendors over others? Many sections require equal treatment or specify the details of priority when assets are insufficient to satisfy all claims. *E.g.*, 11 U.S.C. §§ 507, 1122(a), 1123(a)(4). Appellants rely on 11 U.S.C. §§ 363(b), 364(b), and 503 as sources of authority for unequal treatment. Section 364(b) reads: "The court, after notice and a hearing, may authorize the trustee to obtain unsecured credit or to incur unsecured debt other than under subsection (a) of this section, allowable under section 503(b)(1) of this title as an administrative expense." This authorizes the debtor to obtain credit (as Kmart did) but has nothing to say about how the money will be disbursed or about priorities among creditors. To the extent that *In re Payless Cashways, Inc.*, 268 B.R. 543 (Bankr. W.D. Mo. 2001), and similar decisions, hold otherwise, they are unpersuasive. Section 503, which deals with administrative expenses, likewise is irrelevant. Pre-filing debts are not administrative expenses; they are the antithesis of administrative expenses. Filing a petition for bankruptcy effectively creates two firms: the debts of the pre-filing entity may be written down so that the post-filing entity may reorganize and continue in business if it has a positive cash flow. *See Boston & Maine Corp. v. Chicago Pacific Corp.*, 785 F.2d 562 (7th Cir. 1986). Treating pre-filing debts as "administrative" claims against the post-filing entity would impair the ability of bankruptcy law to prevent old debts from sinking a viable firm.

That leaves § 363(b)(1): "The trustee [or debtor in possession], after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the

estate." This is more promising, for satisfaction of a pre-petition debt in order to keep "critical" supplies flowing is a use of property other than in the ordinary course of administering an estate in bankruptcy. Capital Factors insists that § 363(b)(1) should be limited to the commencement of capital projects, such as building a new plant, rather than payment of old debts—as paying vendors would be "in the ordinary course" but for the intervening bankruptcy petition. To read § 363(b)(1) broadly, Capital Factors observes, would be to allow a judge to rearrange priorities among creditors (which is what a critical-vendors order effectively does), even though the Supreme Court has cautioned against such a step. *See United States v. Reorganized CF&I Fabricators of Utah, Inc.*, 518 U.S. 213, 135 L. Ed. 2d 506, 116 S. Ct. 2106 (1996); *Noland, supra.* Yet what these decisions principally say is that priorities do not change unless a statute supports that step; and if § 363(b)(1) is such a statute, then there is no insuperable problem. If the language is too open-ended, that is a problem for the legislature. Nonetheless, it is prudent to read, and use, § 363(b)(1) to do the least damage possible to priorities established by contract and by other parts of the Bankruptcy Code. We need not decide whether § 363(b)(1) could support payment of some pre-petition debts, because *this* order was unsound no matter how one reads § 363(b)(1).

The foundation of a critical-vendors order is the belief that vendors not paid for prior deliveries will refuse to make new ones. Without merchandise to sell, a retailer such as Kmart will fold. If paying the critical vendors would enable a successful reorganization and make even the disfavored creditors better off, then all creditors favor payment whether or not they are designated as "critical." This suggests a use of § 363(b)(1) similar to the theory underlying a plan crammed down the throats of an impaired class of creditors: if the impaired class does at least as well as it would have under a Chapter 7 liquidation, then it has no legitimate objection and cannot block the reorganization. *See generally Bank of*

America v. 203 N. LaSalle St. Partners, 526 U.S. 434, 143 L. Ed. 2d 607, 119 S. Ct. 1411 (1999). For the premise to hold true, however, it is necessary to show not only that the disfavored creditors *will* be as well off with reorganization as with liquidation—a demonstration never attempted in this proceeding—but also that the supposedly critical vendors would have ceased deliveries if old debts were left unpaid while the litigation continued. If vendors will deliver against a promise of current payment, then a reorganization can be achieved, and all unsecured creditors will obtain its benefit, without preferring any of the unsecured creditors.

Some supposedly critical vendors will continue to do business with the debtor because they must. They may, for example, have long term contracts, and the automatic stay prevents these vendors from walking away as long as the debtor pays for new deliveries. *See* 11 U.S.C. § 362. Fleming Companies, which received the largest critical-vendors payment because it sold Kmart between $70 million and $ 100 million of groceries and related goods weekly, was one of these. No matter how much Fleming would have liked to dump Kmart, it had no right to do so. It was unnecessary to compensate Fleming for continuing to make deliveries that it was legally required to make. Nor was Fleming likely to walk away even if it had a legal right to do so. Each new delivery produced a profit; as long as Kmart continued to pay for new product, why would any vendor drop the account? That would be a self-inflicted wound. To abjure new profits because of old debts would be to commit the sunk-cost fallacy; well-managed businesses are unlikely to do this. Firms that disdain current profits because of old losses are unlikely to stay in business. They might as well burn money or drop it into the ocean. Again Fleming illustrates the point. When Kmart stopped buying its products after the contract expired, Fleming collapsed (Kmart had accounted for more than 50% of its business) and filed its own bankruptcy

petition. Fleming was hardly likely to have quit selling of its own volition, only to expire the sooner.

Doubtless many suppliers fear the prospect of throwing good money after bad. It therefore may be vital to assure them that a debtor will pay for new deliveries on a current basis. Providing that assurance need not, however, entail payment for pre-petition transactions. Kmart could have paid cash or its equivalent. (Kmart's CEO told the bankruptcy judge that COD arrangements were not part of Kmart's business plan, as if a litigant's druthers could override the rights of third parties.) Cash on the barrelhead was not the most convenient way, however. Kmart secured a $2 billion line of credit when it entered bankruptcy. Some of that credit could have been used to assure vendors that payment would be forthcoming for all post-petition transactions. The easiest way to do that would have been to put some of the $2 billion behind a standby letter of credit on which the bankruptcy judge could authorize unpaid vendors to draw. That would not have changed the terms on which Kmart and any of its vendors did business; it just would have demonstrated the certainty of payment. If lenders are unwilling to issue such a letter of credit (or if they insist on a letter's short duration), that would be a compelling market signal that reorganization is a poor prospect and that the debtor should be liquidated post haste.

Yet the bankruptcy court did not explore the possibility of using a letter of credit to assure vendors of payment. The court did not find that any firm would have ceased doing business with Kmart if not paid for pre-petition deliveries, and the scant record would not have supported such a finding had one been made. The court did not find that discrimination among unsecured creditors was the only way to facilitate a reorganization. It did not find that the disfavored creditors were at least as well off as they would have been had the critical-vendors order not been entered. For all the millions at

stake, this proceeding looks much like the Chapter 13 reorganization that produced *In re Crawford*, 324 F.3d 539 (7th Cir. 2003). Crawford had wanted to classify his creditors in a way that would enable him to pay off those debts that would not be discharged, while stiffing the creditors whose debts were dischargeable. We replied that even though classification (and thus unequal treatment) is possible for Chapter 13 proceedings, *see* 11 U.S.C. § 1322(b), the step would be proper only when the record shows that the classification would produce some benefit for the disfavored creditors. Just so here. Even if § 362(b)(1) allows critical-vendors orders in principle, preferential payments to a class of creditors are proper only if the record shows the prospect of benefit to the other creditors. This record does not, so the critical-vendors order cannot stand.

AFFIRMED

APPENDIX B

UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF ILLINOIS, EASTERN DIVISION

No. 02 C 1264 (CONSOLIDATED WITH 02 C 1265, 02 C 2086, 02 C 2088)

CAPITAL FACTORS, INC.,
Appellant,

v.

KMART CORPORATION,
Appellee.

April 8, 2003, Decided
April 10, 2003, Docketed

JOHN F. GRADY, *United States District Judge*.

MEMORANDUM OPINION

Capital Factors, Inc. appeals from four final orders of the bankruptcy court that authorized Kmart to pay certain prepetition obligations. For the reasons explained below, the bankruptcy court's orders are reversed.

BACKGROUND

On January 22, 2002, Kmart Corporation and certain of its domestic subsidiaries and affiliates, debtors and debtors-in-possession (collectively, "Kmart") filed a voluntary petition for reorganization pursuant to Chapter 11 of the United States Bankruptcy Code. As part of its "first day motions" filed on that date, Kmart sought authority to pay prepetition obli-

gations to certain "critical vendors" (the "Critical Vendors Motion") and certain foreign vendors (the "Foreign Vendors Motion"). Kmart contended that these payments were necessary to maintain relationships essential to its continued operation and reorganization, and it invoked the "doctrine of necessity" and 11 U.S.C. § 105(a) for the bankruptcy court's authority to permit these payments.

The same day, the bankruptcy court held a hearing and heard evidence on these motions. Appellant Capital Factors, Inc. ("Capital") objected to both motions. (Capital is a factoring agent n1 for a number of Kmart's apparel suppliers, and it holds general unsecured claims against the bankruptcy estate of approximately $ 20 million.)[1]

Regarding the Critical Vendors Motion, the court stated:

> Motions to pay certain critical trade creditors always present difficult questions for courts. We're seeing more and more of them, and our problem is that we have to stretch to find some authority to do them. However, I, after hearing this testimony and reading the affidavit [of Charles C. Conaway, Kmart's Chief Executive Officer], am convinced that Fleming, Handleman and the egg and dairy vendors—and I would like a list of the specific vendors that you would like included in this motion--as well as the advertising concerns, are necessary to keep this business going as a going concern.

(App. to Appellee's Brief, Ex. 4A, at 162.) Accordingly, the bankruptcy court granted the Critical Vendors Motion. Without reciting specific findings from the bench, the bankruptcy court also granted the Foreign Vendors Motion.

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[1] A factoring agent purchases accounts receivable from its customers and assumes the collection responsibilities. *See Mr. Furniture Warehouse, Inc. v. Barclays Am./Commercial Inc.*, 919 F.2d 1517, 1519 (11th Cir. 1990).

(*Id.* at 173.) On January 25, the bankruptcy court entered written orders granting both motions.

On February 1 and 8, 2002, Kmart filed motions seeking authority to pay issuers of prepetition letters of credit (the "Letters of Credit Motion") and prepetition claims of certain liquor vendors (the "Liquor Vendors Motion"). On February 13, the bankruptcy court held a hearing on these motions, heard evidence, and granted both motions over Capital's objections. Regarding the Letters of Credit Motion, the court stated:

> Because the foreign vendors are integral to the reorganization of this Debtor and the Court already ruled on the payment of certain foreign vendors as part of the critical vendors motions and I believe that this is just a component of that particular transaction, and further finding that I may be inconsistent if I do not grant the relief that is requested here, I am going to go ahead and sign your order authorizing the reimbursement of the obligations to the issuers of Letters of Credit.

(*Id.*, Ex. 4B, at 251.) The bankruptcy court also granted the Liquor Vendors motion, "finding that there [was] a good business justification for it." (*Id.* at 269.) Written orders granting the motions were entered that same day.

Capital filed notices of appeal from each order, and we granted Capital's motion to consolidate the appeals. The parties' briefing is complete, and we heard oral argument on the appeals as well.

DISCUSSION

This court has jurisdiction over the instant appeals pursuant to 28 U.S.C. § 158(a)(1). On appeal from an order of the bankruptcy court, we review the bankruptcy court's factual findings under a "clearly erroneous" standard and its con-

clusions of law de novo. *See In re Smith*, 286 F.3d 461, 464-65 (7th Cir. 2002); *Fed. R. Bankr. P.* 8013.

Capital raises the following issues on appeal: (1) whether 11 U.S.C. § 105(a) or the "doctrine of necessity" provides a bankruptcy court with either statutory authority or equitable power to allow the payment of selected prepetition unsecured trade claims prior to confirmation of a Chapter 11 plan[2]; (2) whether there was a sufficient evidentiary basis for the bankruptcy court to allow payment of certain prepetition claims; and (3) whether state laws prohibiting liquor wholesalers from selling products to Chapter 11 debtors legally unable to pay their prepetition debt are invalid or unenforceable to the extent that they conflict with the Bankruptcy Code.[3] Kmart raises the additional issue of whether Capital's appeals are moot because Kmart has already paid a substantial portion of the prepetition claims.

A. The Bankruptcy Court's Power Under § 105

We first examine the question of whether the bankruptcy court had the power to authorize the pre-plan payment of prepetition claims. The court relied on 11 U.S.C. § 105(a) to authorize the payments. *Section* 105(a) addresses the equitable powers of bankruptcy courts and provides:

> The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be

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[2] For convenience, we will refer to the time period prior to confirmation of a Chapter 11 plan as "pre-plan."

[3] Capital also raises what it deems a separate issue of whether "a bankruptcy court may utilize" § 105(a) or the "doctrine of necessity" "to circumvent explicit provisions of the Bankruptcy Code." (Appellant's Brief at 2.) We view this issue as being part and parcel of the first issue listed supra.

> construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.

11 U.S.C. § 105(a). Although the bankruptcy court did not refer specifically to the equitable "doctrine of necessity" when ruling on the motions in open court or in its written orders,[4] Kmart relies on the doctrine. It is derived from the "necessity of payment rule," which was developed and used in railroad reorganizations "as justification for the payment of pre-petition debts paid under duress to secure continued supplies or services essential to the continued operation of the railroad." *B & W Enters., Inc. v. Goodman Oil Co. (In re B & W Enters., Inc.)*, 713 F.2d 534, 537 (9th Cir. 1983). The rule has subsequently evolved into the "doctrine of necessity," which has been applied in non-railroad reorganizations to justify the pre-plan payment of prepetition claims of creditors who threaten to withhold goods or services believed critical to the debtor's continued viability and reorganization.[5] The doctrine is not codified anywhere in the Bankruptcy Code, so the only way to apply it is through § 105.

The Seventh Circuit has stated that the grant of equitable power in § 105 is limited in that it "allows [bankruptcy] Courts to use their equitable powers only as necessary to enforce the provisions of the Code, not to add on to the Code as they see fit." *In re Fesco Plastics Corp.*, 996 F.2d 152, 156 (7th Cir. 1993); *see* also *Gouveia v. Tazbir*, 37 F.3d 295, 300 (7th Cir. 1994) ("The Supreme Court has taught that any grant of authority given to the bankruptcy courts under § 105

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[4] As noted supra, the bankruptcy court did, however, find that the payments were "necessary," "integral," and that there was "good business justification" for them.

[5] *See* 2 William L. Norton, Jr., Norton Bankr. L. & Prac. 2d § 42:11 (Supp. 2002), for a good discussion of the doctrine's history.

must be exercised within the confines of the bankruptcy code.") (citing *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 99 L. Ed. 2d 169, 108 S. Ct. 963 (1988)).

The Bankruptcy Code sets forth a priority scheme for the payment of claims. *See* 11 U.S.C. §§ 503, 507. The Code does not carve out priority or administrative expense status for prepetition general unsecured claims based on the "critical" or "integral" status of a creditor. But the effect of the bankruptcy court's orders was to elevate the claims of the "critical" vendors over those of other unsecured creditors and to subordinate the claims of non-"critical" unsecured creditors. The bankruptcy court altered the priority scheme set forth in the Bankruptcy Code.

There is a split in the courts regarding whether § 105 authorizes bankruptcy courts to permit pre-plan payment of prepetition unsecured claims. As set forth in Kmart's briefs, many bankruptcy courts and a handful of district courts have held that bankruptcy courts do in fact have this power. *See, e.g., In re Just For Feet, Inc.*, 242 B.R. 821 (D. Del. 1999); *Michigan Bureau of Workers' Disability Comp. v. Chateaugay Corp.* (*In re Chateaugay Corp.*), 80 B.R. 279 (S.D.N.Y. 1987); *In re CoServ, L.L.C.*, 273 B.R. 487 *(Bankr. N.D. Tex. 2002)*; *In re Wehrenberg, Inc.*, 260 B.R. 468 (*Bankr. E.D. Mo.* 2001).

On the other hand, as Capital points out, a number of courts of appeals and a few lower courts have held just the opposite. *See, e.g., Official Comm. of Equity Sec. Holders v. Mabey*, 832 F.2d 299 (4th Cir. 1987); *B & W Enters., Inc. v. Goodman Oil Co.* (*In re B & W Enters., Inc.*), 713 F.2d 534 (9th Cir. 1983); *Chiasson v. J. Louis Matherne & Assocs.* (*In re Oxford Mgmt. Inc.*), 4 F.3d 1329 (5th Cir. 1993); *In re FCX, Inc.*, 60 B.R. 405 *(E.D.N.C. 1986)*; *In re Timberhouse*

Post & Beam, Ltd., 196 B.R. 547 (Bankr. D. Mont. 1996).[6] We agree with the latter courts' view that we cannot ignore the Bankruptcy Code's statutory scheme of priority in favor of "equity," especially in light of the Seventh Circuit's admonition that "the fact that a [bankruptcy] proceeding is equitable does not give the judge a free-floating discretion to redistribute rights in accordance with his personal views of justice and fairness, however enlightened those views may be." *In re Chicago, Milwaukee, St. Paul & Pac. R.R. Co.*, 791 F.2d 524, 528 (7th Cir. 1986).

We acknowledge that the application of the "doctrine of necessity" through § 105 in this situation is well-intended and may even have some beneficial results, in that pre-plan payment of certain prepetition claims allows the debtor to minimize disruptions in doing business, and thus may further reorganization. Nevertheless, it is clear that however useful and practical these payments may appear to bankruptcy courts, they simply are not authorized by the Bankruptcy Code. Congress has not elected to codify the doctrine of necessity or otherwise permit pre-plan payment of prepetition unsecured claims.

Because we hold that the bankruptcy court did not have either the statutory or equitable power to authorize the pre-plan payment of prepetition unsecured claims, we need not address the second and third issues Capital raises on appeal.

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[6] Cf. *Shapiro v. Saybrook Mfg. Co.* (*In re Saybrook Mfg Co.*), 963 F.2d 1490 (11th Cir. 1992) (bankruptcy court had no authority to allow cross-collaterization, a method of securing prepetition debt with prepetition and postpetition collateral); *Southern Ry. Co. v. Johnson Bronze Co.* (*In re Johnson Bronze Co.*), 758 F.2d 138 (3d Cir. 1985) (bankruptcy court had no authority to grant lien status to a prepetition contractual indemnification claim); *Crowe & Assocs., Inc. v. Bricklayers & Masons Union Local No. 2* (*In re Crowe & Assocs., Inc.*), 713 F.2d 211, 216 (6th Cir. 1983) (dictum).

B. "Equitable Mootness"

Kmart does not persuade us that Capital's appeals are moot due to the fact that the prepetition claims have been substantially paid. Kmart makes much of the fact that Capital did not seek a stay of the bankruptcy court's orders. It is highly unlikely, however, that a motion to stay would have been successful. It would be inconsistent for the bankruptcy court to enter the orders on the theory that prompt payments were necessary to keep Kmart operational, and then turn around and stay those orders.[7] In any event, Capital was not required to seek a stay of the orders in order to preserve its appellate rights.

Kmart also argues that the appeals are "equitably moot" because effective relief on appeal has become imprudent and inequitable. The term "equitable mootness" was "anathematized by Judge Easterbrook"[8] in the case of *In re UNR Industries, Inc.*, 20 F.3d 766, 768 (7th Cir. 1994). The Seventh Circuit in UNR "banished the term 'equitable mootness' from the (local) lexicon," 20 F.3d at 769, because it is misleading: "there is a big difference between inability to alter the outcome (real mootness) and unwillingness to alter the outcome ('equitable mootness')." *Id.* Nonetheless, the "now nameless doctrine" lives on and "is perhaps best described as merely an application of the age-old principle that in formulating equitable relief a court must consider the effects of the relief on innocent third parties." *Envirodyne,* 29 F.3d 301 at 304. The basic questions under the doctrine, then,

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[7] *See* Charles Jordan Tabb, Emergency Preferential Orders in Bankruptcy Reorganizations, 65 *Am. Bankr. L.J.* 75, 108 (1991).

[8] *In re Envirodyne Indus., Inc.*, 29 F.3d 301, 304 (7th Cir. 1994).

are these: is it prudent and fair to undo what the bankruptcy court did?[9] *See UNR*, 20 F.3d at 769; *Envirodyne*, 29 F.3d at 304.

Kmart argues that we should not reverse the orders allowing payment of the prepetition claims because the parties receiving the payments have already acted in reliance on them. As noted supra note 9, however, this is not a situation where there has been confirmation of a bankruptcy plan. Accordingly, it is not too late to order that the monies paid be returned. Kmart also claims that undoing the bankruptcy court's orders would "paralyze" Kmart by forcing it to "undergo the Herculean task of immediately commencing thousands of lawsuits to collect hundreds of millions of dollars from thousands of vendors." (Appellee's Brief at 45-46.) We are not persuaded by Kmart's doomsday speculations. It is not evident that Kmart will have to sue to recover the payments, and in fact, Kmart cites no cases indicating that the bankruptcy court would not have the power to order the return of the monies paid.

C. J.P. Morgan Chase's Brief

J.P. Morgan Chase ("JPM"), which is an "administrative agent for the lenders under various pre-petition credit agreements among such lenders and Kmart" (JPM Brief at 1), has filed a supplemental brief regarding the Letters of Credit Motion. JPM contends that, even if the bankruptcy court did not have the authority under § 105 to authorize Kmart to pay the prepetition claims of the issuers of the letters of credit, the court "properly allowed those payments [pursuant to § 361 of

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[9] As Capital points out, it is worth noting that most of the cases addressing or applying the doctrine involved appeals of orders confirming bankruptcy plans of reorganization. *See, e.g.*, UNR, 20 F.3d 766; *Mac Panel Co. v. Virginia Panel Corp.*, 283 F.3d 622 (4th Cir. 2002). Those cases are distinguishable from the instant proceeding because there has not yet been a confirmation of Kmart's plan.

the Bankruptcy Code] on the basis that such payments constituted adequate protection for the Issuers' secured reimbursement claims under the Letters of Credit." (JPM Brief at 2.) According to JPM, the issuers had statutory liens in the documents and the proceeds thereof presented by the foreign vendors to obtain payment under the letters of credit, and the issuers were entitled to adequate protection of those liens under § 361 of the Code. [10]

In authorizing the payments to the issuers of the letters of credit, the bankruptcy court did not rely on § 361. We may affirm the bankruptcy court's decision on an alternative ground, but that ground must have been adequately presented in the bankruptcy court. See *Anderson v. U.S.F. Logistics (IMC), Inc.*, 274 F.3d 470, 478 (7th Cir. 2001) (citing *Logan v. Caterpillar, Inc.*, 246 F.3d 912, 924 (7th Cir. 2001)). Neither Kmart nor the issuers raised the adequate protection issue at the hearing on the Letters of Credit Motion. The bankruptcy court was not presented with evidence on whether the issuers held valid security interests nor whether they were entitled to adequate protection. There is an insufficient basis

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[10] *Section* 361 provides:

> When adequate protection is required under *section* 362, 363, or 364 of this title of an interest of an entity in property, such adequate protection may be provided by—
>
> 1) requiring the trustee to make a cash payment or periodic cash payments to such entity, to the extent that the stay under *section* 362 of this title, use, sale, or lease under *section* 363 of this title, or any grant of a lien under *section* 364 of this title results in a decrease in the value of such entity's interest in such property;
>
> 2) providing to such entity an additional or replacement lien to the extent that such stay, use, sale, lease, or grant results in a decrease in the value of such entity's interest in such property; or
>
> 3) granting such other relief, other than entitling such entity to compensation allowable under *section* 503(b)(1) of this title as an administrative expense, as will result in the realization by such entity of the indubitable equivalent of such entity's interest in such property.

in the record to allow a finding that the payments to the issuers constituted adequate protection under § 361 of the Bankruptcy Code.

CONCLUSION

For the foregoing reasons, the following orders of the bankruptcy court are reversed: (1) Order Under 11 U.S.C. § 105 (a) Authorizing the Payment of Prepetition Claims of Certain Critical Trade Vendors; (2) Order Pursuant to 11 U.S.C. §§ 105 (a) and 363 Authorizing Payment of Prepetition Obligations Necessary to Obtain Imported Merchandise; (3) Order Pursuant to 11 U.S.C. §§ 105(a) and 363 Authorizing the Debtors to Honor Reimbursement Obligations to Issuers of Pre-Petition Letters of Credit Issued for the Benefit of the Debtors' Foreign Vendors; and (4) Order Under 11 U.S.C. § 105(a) Authorizing the Payment of Prepetition Claims of Certain Liquor Vendors.

The case is remanded for further proceedings consistent with this opinion.

DATE: April 8, 2003

ENTER:

John F. Grady, *United States District Judge*

APPENDIX C

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

[Filed Jan. 26, 2002]

Case No. 02-B02474
(Jointly Administered)
Chapter 11
Chief Judge Susan Pierson Sonderby

In re: KMART CORPORATION, *et al.*,
Debtors.

ORDER UNDER 11 U.S.C. 105(a) AUTHORIZING THE PAYMENT OF PREPETITION CLAIMS OF CERTAIN CRITICAL TRADE VENDORS

Upon the motion dated January 22, 2002 (the "Motion"), wherein Kmart Corporation ("Kmart") and certain of its domestic subsidiaries and affiliates, debtors and debtors-in-possession in the above-captioned eases (collectively, the "Debtors" or the "Company"), moved this Court for entry of an order, pursuant to section 105(a) authorizing the Debtors to pay Critical Vendor Claims; it appearing to the Court that (i) it has jurisdiction over the matters raised the Motion pursuant to 28 U.S.C. §§ 157 and 1334; (ii) this is a core proceeding pursuant to 28 U.S.C. 157(b)(2); (iii) the relief requested in the Motion is in the best interests of the Debtors, their estates and their creditors; (iv) proper and adequate notice of the Motion and the hearing thereon has been given and that no other or further notice is necessary; and (v) upon the record herein, including the exhibits attached to the Notice of Filing of Exhibits as Ordered by the Court at the

January 22, 2002 Hearing, filed on or about January 25, 2002, after due deliberation thereon, the relief should be granted as set forth below,

1. The Debtors are authorized, but not directed, in the reasonable exercise of their business judgment, to pay all, a portion or none of the prepetition claims (the "Critical Vendor Claims") of the following "Critical Vendors": (a) Fleming Companies, Inc,; (b) Handleman Company; (c) vendors who supply egg and dairy and (d) certain newspapers, printers, paper suppliers and other vendors who supply goods and services related to the Debtors' advertising program The payment of the Critical Vendor Claims shall not exceed those set forth in the Motion upon such terms and in the manner provided in this Order and subject to the provisions of the Debtors' postpetition financing agreement.

2. Any checks used by the Debtors to pay Critical Vendor Claims shall contain a legend substantially in the following form:

   By accepting this check, the payee agrees to the terms of that certain Order of the United States Bankruptcy Court for the Northern District of Illinois, dated as of _____, in the payor's chapter 11 case (Case No _____), entitled "Order Under 11 U.S.C. § 105(a) Authorizing the Payment of Prepetition Claims of Certain Critical Trade Vendors," (including, if applicable, any Trade Agreement entered into pursuant to that Order) and submits to the jurisdiction of that Court for enforcement thereof.

3. The Debtors shall undertake appropriate efforts to cause Critical Vendors to enter into an agreement with the Debtors as provided herein as a condition of payment of

their Critical Vendor Claims, which agreement shall include the following terms:

(a)The amount of such Critical Vendor's estimated Critical Vendor Claims, accounting for any setoffs, other credits and discounts thereto, shall be as mutually determined in good faith by the Critical Vendor and the Debtors (but such amount shall be used only for the purposes of determining such Critical Vendor's claim under this Order and shall not he deemed a claim allowed by the Court and the rights of all interested persons to object to such claim shall be fully preserved until further order of this Court);

(b)The Customary Trade Terms between such Critical Vendor and the Debtors, or such other terms as the Critical Vendors and the Debtors may agree;

(c)The Critical Vendor's agreement to provide goods and services to the Debtors based upon Customary Trade Terms or on such other favorable terms as the Debtors and the Critical Vendor may otherwise agree, for a period at least two (2) years from the Petition Date, and the Debtors' agreement to pay in accordance with such terms;

(d)The Critical Vendor's agreement not to file or otherwise assert against any or all of the Debtors, their estates or any other person or entity or any of their respective assets or property (real or personal) any lien (a "Lien"), regardless of the statute or other legal authority upon which such Lien is asserted, related in any way to any remaining prepetition amounts allegedly owed to the Critical Vendor by the Debtors arising from agreements or other arrangements entered into prior to the petition Date, and, to the extent the Critical Vendor has already obtained or otherwise asserted such a Lien, the Critical Vendor shall take whatever actions are necessary to remove such Lien;

(e)The Critical Vendor's acknowledgment that is has reviewed the terms and provisions of this order and consents to be bound hereby; and

(f)The Critical Vendor's agreement that it will not separately seek payment for reclamation claims outside the terms of this Order unless the Critical Vendor's participation in the program to pay Critical Vendor Claims pursuant to this Order is terminated; *provided, however*, that such reclamation claims shall, if thereafter raised by the Critical Vendor as permitted by this Order, be treated as though raised on the date of this Order.

An agreement executed by and between the Debtors and a Critical Vendor as set forth in this paragraph shall be referred to as a "Trade Agreement." This order is intended to authorize, but shall not require, the Debtors to enter into Trade Agreements, it being the express intention of this Court that the Debtors shall enter into Trade Agreements only when the Debtors determine, in the exercise of their reasonable business judgment, that it is appropriate to do so.

4. The Debtors are authorized, in their discretion to make payments on account of Critical Vendor Claims in the absence of a Trade Agreement after the Debtors have undertaken diligent efforts to cause the Critical Vendor holding such Critical Vendor Claim to execute a Trade Agreement and if the Debtors determine, in their business judgment, that failure to pay the Critical Vendor Claim is likely to result in irreparable harm to the Debtors' business operations.

5. If a Critical Vendor refuses to supply goods and/or services to the Debtors on Customary Trade Terms following receipt of payment on its Critical Vendor Claim, or fails to comply with any Trade Agreement entered into between such Critical Vendor and the Debtors, then the Debtors may, in their discretion and without further order of the Court, (a) declare that any Trade Agreement between the Debtors and such Critical Vendor is terminated (if applicable), and (b)

declare that provisional payments made to Critical Vendors on account of Critical Vendor Claims be deemed to have been in payment of then-outstanding post-petition claims of such vendors without further order or the Court or action by any person or entity, and, to the extent that payments on account of such Critical Vendor Claims exceed the postpetition claims of such vendors then outstanding without giving effect to any rights of setoff, claims, provision for payment of reclamation or trust fund claims, or otherwise. In the event a Trade Agreement is terminated or a Critical Vendor refuses to supply goods and/or services to the Debtors on Customary Trade Terms following receipt of payment on its Critical Vendor Claim, it is the explicit intention of this Court to return the parties to their position immediately prior to the entry of the order approving this Motion with respect to all prepetition claims.

6. The Debtors may, in their sole discretion, reinstate a Trade Agreement if:

(a)Such determination is subsequently reversed by the Court, after notice and a hearing following a motion by the Critical Vendor, for good cause shown that the determination was materially incorrect;

(b)The underlying default under the Trade Agreement was fully cured by the Critical Vendor not later than five (5) business days following the Debtors' notification to the Critical Vendor that a default had occurred; or

(c)The Debtors, in their discretion, reach a favorable alternative agreement with the Critical Vendor.

7. Nothing herein shall be construed to limit, or in any way affect, the Debtors' ability to dispute any Critical Vendor Claim.

8. Nothing contained in this order shall be deemed to constitute an assumption or rejection of any executory contract or agreement between the Debtors and a Critical Vendor or

to require the Debtors to make any of the payments authorized herein.

9. Notwithstanding the relief granted herein and any actions taken hereunder, nothing contained herein shall create, nor is it intended to create, any rights in favor of, or enhance the status of any claim held by, any person.

10. This Court shall retain jurisdiction to construe and enforce this Order.

Dated: Chicago, Illinois January 25, 2002

/s/ SUSAN PIERSON SONDERBY
Chief Judge SUSAN PIERSON SONDERBY
UNITED STATES BANKRUPTCY JUDGE

EXHIBIT A

_____, 2002

TO: [Essential Trade Creditor]
[Name]
[Address]

Dear Valued Supplier:

As you are no doubt aware, on _____, 2002 (the "Petition Date"), [Debtor], together with certain of its U.S. affiliates (collectively, the "Debtors"), filed voluntary petitions under chapter 11 of the United States Bankruptcy Code in the United States Bankruptcy Court for the Northern District of Illinois (the "Bankruptcy Cases" and the "Bankruptcy Court," respectively). On the Petition Date, we requested the Bankruptcy Court's authority to pay certain suppliers in recognition of the importance of our relationship with such suppliers and our desire that the Bankruptcy Cases have as little effect on them as possible. On _____, 2002, the Bankruptcy Court entered an: order (the "Order'") authorizing us, under certain conditions, to pay pre-bankruptcy claims of certain trade creditors that agree to the terms set

forth below and to be bound by the terms of the Order. A copy of the Order is enclosed.

In order to receive payment on pre-bankruptcy claims, each selected trade creditor must agree to continue supplying goods to the Debtors based on "Customary Trade Terms," In the Order, Customary Trade Terms are defined as the normal and customary trade terms, practices and programs (including, but not limited to, credit limits, pricing, cash discounts, timing of payments, allowance, rebates, coupon reconciliation, normal product mix and availability and other applicable terms and programs) in effect between such trade creditor and the Debtors on a historical basis prior to the Petition Date or such other trade terms, practices and programs that are at least as favorable to the Debtors as those in effect during such time.

For purposes of administration of this trade program as authorized by the Bankruptcy Court, the Debtors and you agree as follows:

1. The estimated balance of the prepetition trade claim (net of any setoffs, credits or discounts (the "Trade Claim") that the Debtors will provisionally pay you is $

2. You will provide open credit terms as follows (if more space is required, attach continuation pages)

3. The open trade balance or credit line that you will extend to the Debtors for shipment of postpetition goods is $ _____ 3 (which shall not be less than the greater of the open trade balance outstanding: (a) on _____, 2002, or (b) on normal and customary terms on a historical basis for the period prior to the Petition Date).

4. In consideration for the payment described herein, you agree not to file or otherwise assert against any or all of the Debtors, their estates or any other person or entity or any of their respective assets or property (real or personal) any lien (regardless of the statute or other legal authority

upon which such lien is asserted) related in any way to any remaining prepetition amounts allegedly owed to you by the Debtors arising from agreements entered into prior to the Petition Date. Furthermore, if you have taken steps to file or assert such a lien prior to entering into this letter agreement, you agree to take all necessary steps to remove such lien as soon as possible.

5. You will hereafter extend to the Debtors all Customary Trade Terms (as defined in the Order).

Payment of your Trade Claim in the manner set forth in the Order may only occur upon execution of this letter by a duly authorized representative of your company and the return of this letter to the Debtors. Your execution of this letter agreement anti return of the same to the Debtors constitutes an agreement by you and the Debtors:

(a) to the Customary Trade Terms and, subject to the reservations contained in the Order, to the amount of the Trade Claim set forth above;

(b) that, for a period of no less that two (2) years from the Petition Date, you will continue to supply the Debtors with goods, pursuant to the Customary Trade Terms and that the Debtors will pay for such goods in accordance with Customary Trade terms;

(c) that you have reviewed the terms and provisions of the Order and that you consent to be bound by such teams;

(d) that you will not separately seek payment for reclamation and similar claims outside of the terms of the Order unless your participation in the trade payment program authorized by the Order (the'" 'Trade Payment Program') is terminated; and

(e) that if either the Trade Payment Program or your participation therein terminates as provided in the Order, any payments received by you on account of your Trade

Claim will be deemed to have been in payment of then outstanding postpetition obligations owed to you and that you will immediately repay to the Debtors any payments made to you on account of your Trade claim to the extent that the aggregate amount of such payments exceed the postpetition obligations then outstanding without the right of any setoffs, claims, provision for payment of reclamation or trust fund claims or otherwise.

The Debtors and you also hereby agree that any dispute with respect to this agreement, the Order and/or your participation in the Trade Payment Program shall be determined by the Bankruptcy Court.

If you have any questions about this Agreement or our financial restructuring, please do not hesitate to call (___) ___ or (___) ___.

Sincerely,

[Debtor]

By:

Its:

Agreed. and Accepted by:
[Name of Trade Vendor]

By:

Its:

Dated:

APPENDIX D

UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

[Filed Feb. 1, 2002]

Chapter 11
No. 02 B 02474 (Jointly Administered)
Hon. Susan Pierson Sonderby.

IN RE: KMART CORPORATION, *et al.*,
Debtors.

NOTICE OF APPEAL FROM ORDER UNDER
11 U.S.C. § 105(a) AUTHORIZING THE PAYMENT
OF PREPETITION CLAIMS OF CERTAIN
CRITICAL TRADE VENDORS

Pursuant to 28 U.S.C. § 158(a), Capital Factors, Inc. ("Capital") appeals from an order dated January 25, 2002, entitled "Order Under 11 U.S.C. § 105(a) Authorizing The Payment Of Prepetition Claims Of Certain Critical Trade Vendors," a copy of which is annexed hereto as Exhibit A and incorporated herein by this reference. A list of names of all parties known to Capital that have filed appearances or requests for notice in these jointly administered chapter 11 cases is annexed hereto as Exhibit B and incorporated herein by this reference.

Respectfully submitted,

Capital Factors, Inc.
By: /s/ Steven B. Towbin
One of its attorneys

Dated: February 1, 2002

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In re Kmart Corporation, Case No.: 02-02474

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APPENDIX E

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

Case No. 02-B02474
(Jointly Administered)
Chapter 11
Chief Judge Susan Pierson Sonderby

ORDER PURSUANT TO 11 U.S.C. §§ 102 AND 105(a),BANKRUPTCY RULES 2002(m) AND 9907, AND LOCAL RULES 101, 400, AND 402 ESTABLISHING OMNIBUS HEARING DATES AND CERTAIN NOTICE, CASE MANAGEMENT AND ADMINISTRATIVE PROCEDURES

Upon the motion (the "Motion"), of Kmart Corporation and 37 of its subsidiaries and affiliates (the "Affiliate Debtors'), debtors and debtors-in-possession in the above-captioned cases (collectively, the "Debtors"), for entry of an order, pursuant to sections 102(1) and 105(a) of chapter 11 of title 11 of the United States Code, 11 U.S.C. §§ 101, *et seq.* (the "Bankruptcy Code"), Rules 2002(m) and 9007 of the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules"), and Local Rules 101, 401, and 402 (the "Local Rules") establishing omnibus hearing dates and certain notice, case management, and administrative procedures in the Debtors' chapter 11 cases; and upon the Affidavit of Charles C. Conaway in Support of Chapter 11 Petitions and First Day Orders; it appearing to the Court that (i) it has jurisdiction over the matters raised in the Motion pursuant to 28 U.S.C. §§ 157 and 1334; (ii) this is a core proceeding

pursuant to 28 U.S.C. § 157(b)(2); (iii) the relief requested in the Motion is in the best interests of the Debtors, their estates and their creditors; (iv) proper and adequate notice of the Motion and the hearing thereon has been given and that no other or further notice is necessary; and (v) upon the record herein, after due deliberation thereon, that the relief should be granted as set forth below,

A. Monthly Omnibus Hearing Dates

1. The Court shall conduct the following omnibus hearings on a monthly basis (or as otherwise set by the Court) in these cases (the "Omnibus Hearing Dates"):

   February 13, 2002 at 11:00 a.m. (Central Time)

   March 6, 2002 at 11:00 a.m. (Central Time)

   March 20, 2002 at 11:00 a.m. (Central Time)

   April 24, 2002 at 11:00 a.m. (Central Time)

   May 29, 2002 at 11:00 a.m. (Central Time)

   June 26, 2002 at 11:00 aim (Central Time)

   July 31, 2002 at 11:00 a.m. (Central Time)

   August 29, 2002 at 11:00 a.m. (Central Time)

   September 25, 2002 at 11:00 a.m. (Central Time)

   October 30, 2002 at 11:00 a.m. (Central Time)

   November 20, 2002 at 11:00 a.m. (Central Time)

   December 18, 2002 at 11:00 a.m. (Central Time)

2. Omnibus Hearing Dates will occur thereafter as may he scheduled by the Court, All matters requiring a hearing in these cases shall be set for and be heard on Omnibus Hearing Dates unless alternative hearing dates are approved by the Court for good cause shown.

B. Notice Procedures

3. Every Filing shall be subject to the following Notice Procedures described herein. All Filings shall be filed with the Court in accordance with the Local Rules. All Filings shall be served on any entity with a particularized interest in the subject of the Filing. All Filings in these cases shall also be served upon the following list (the "Master Service List") of parties or entities:

(a)The Debtors at Kmart Corporation, Kmart Resource Center, 3100 West Big Beaver Road, Troy, Michigan 48084-3163 (Attn: Janet Kelley) and their counsel;

(b)Counsel to the Debtors, Skadden, Arps, Slate, Meagher & Flom (Illinois), 333 West Wacker Drive, Suite 2100, Chicago, Illinois 60606 (Attn: John Wm. Butler, Jr.)

(c)The Office of the United States Trustee, 227 West Monroe Street, Suite 3350, Chicago, Illinois 60606 (Attn: Kathryn Gleason);

(d)Counsel to any official committee(s) established in these cases pursuant to section 1102 of the Bankruptcy Code (the "Committee(s)) (who shall serve a notice of appearance on the Master Service List promptly after its retention);

(e)Counsel to the administrative agents for the Debtors' postpetition lenders, Morgan Lewis Bockins,101 Park Avenue, New York, New York 10178 (Attn: Robert H. Scheibe and Jay Teitelbaum);

(f)Counsel to the Debtors' prepetition lenders, Simpson, Thatcher & Bartlett, 425 Lexington Avenue, New York, New York 10017 (Attn: Peter V. Pantaleo);

(g)In accordance with Local Rule 603A, all Local Counsel having entered a notice of appearance in these cases, but in each such case, only one copy the Filing regardless of how many creditors or parties-in-interest the Local Counsel represents; and

(h)Those parties that may be added to the Master Service List upon written request to the Debtors and the Committee(s) and as ordered by the Court for good and sufficient cause pursuant to Local Rules 403A(2) and 422 and as required hereby.

4. Parties may be added or deleted from the Master Service List upon written request for good and sufficient cause, in accordance with the procedures set forth in this Order.

5. All initial Filings, complaints and other pleadings filed in any adversary proceeding commenced in these cases (the "Adversary Pleadings") shall be served on (a) the Debtors and their counsel; (b) the Office of the United States Trustee; (c) counsel to the Committees; (d) counsel to the agent for the Debtors' postpetition credit facility; (e) counsel to the Debtors' prepetition lenders, as well as any parties required to be served under any applicable Bankruptcy Rule or Local Rule, in the manner provided by the Bankruptcy Rules that govern adversary proceedings. Subsequent Adversary Pleadings shall be served on parties to the underlying adversary proceeding, in the manner provided by the Bankruptcy Rules that govern adversary proceedings.

6. With respect to all Filings for which particular notices are required by Bankruptcy Rules 2002(a)(2) and (3), 4001, 6004, 6006, 6007 or 9019, parties shall serve all such Filings on the Master Service List herein and also in accordance with the following procedures, unless otherwise authorized by the Court:

(a)Filings related to the use, sale, lease or abandonment of property other than in the ordinary course of business shall be served on each entity asserting an interest in the property.

(b)Filings related to relief from, or otherwise related to, the automatic stay shall be served on each entity asserting a lien or encumbrance on the affected property.

(c)Filings relating to the use or cash collateral or obtaining credit shall be served on each adversely affected entity asserting an interest in the cash collateral or each adversely affected entity asserting a lien or other interest in property on which a lien is proposed to be granted.

(d)Filings relating to approval of proposed compromises or settlements shall be served on any entity that is a party to the compromise or settlement or which may be directly adversely affected thereby.

(e)Filings relating to rights under section 365 of the Bankruptcy Code shall be served on each party to the executory contract(s) or unexpired lease(s) affected thereby.

(f)Filings relating to applications for payment of compensation or reimbursement of expenses shall be served on each professional person who is seeking payment of compensation or reimbursement of expenses and whose retention has been authorized by the Court in these cases,

(g)Notice of other matters for which the Bankruptcy Rules specifically require notice to all parties-in-interest shall be served on all creditors and equity security holders of the Debtors and parties-in-interest, except as set forth herein or as otherwise authorized by this Court.

7. Except as set forth, herein or otherwise authorized by this Court, the noticing procedures set forth above shall not apply to notices of the matters or proceedings described in the following Bankruptcy Rules:

(a)Bankruptcy Rule 2002(a)(1) (meeting of creditors pursuant to section 341 of the Bankruptcy Code).

(b)Bankruptcy Rule 2002(a)(2) (any proposed use, sale or lease of property of the estate other than in the ordinary course of business, to the extent that such use,

sale or lease concerns all or substantially all of the Debtors' assets),

(c)Bankruptcy Rule 2002(a)(3) (the hearing on approval of a compromise or settlement of a controversy other than approval of an agreement pursuant to Bankruptcy Rule 4001(d)(i), to the extent that such compromise or settlement either involves claims between and among the Debtors and any Committee or a plan of reorganization),

(d)Bankruptcy Rule 2002(a)(4) (a hearing on the dismissal of the case or cases, or the conversion of the case or cases to another chapter).

(e)Bankruptcy Rule 2()02(a)(5) (the time fixed to accept or reject a proposed modification of a plan of reorganization).

(f)Bankruptcy Rule 2002(b)(1) (the time fixed for filing objections and any hearing to consider approval of a disclosure statement).

(g)Bankruptcy Rule 2002(b)(2) (the time fixed for filing objections and any hearing to consider confirmation of a plan of reorganization).

(h)Bankruptcy Rule 2002(d) (certain matters for which notice is to be provided to equity security holders).

(i)Bankruptcy Rule 2002(f)(1) (the entry of an order for relief).

(j)Bankruptcy Rule 2002(f)(2) (the dismissal or conversion of a case to another chapter of the Bankruptcy Code).

(k)Bankruptcy Rule 2002(f)(3) (the time allowed for filing claims pursuant to Rule 3002).

(l)Bankruptcy Rule 2002(f)(6) (the waiver, denial or revocation of a discharge as provided in Bankruptcy Rule 4006).

(m)Bankruptcy Rule 2002(f)(7) (the entry of an order confirming a chapter 11 plan or plans of reorganization)

(n) Bankruptcy Rule 2002(0(8) (a summary of the trustee's final report and account should a case be converted to chapter 7 of the Bankruptcy Code).

8. Any entity submitting a Filing shall serve a notice of such filing on all 2002 List Parties (defined below). Such notice shall include the title of the Filing and the time and date of any objection deadline and the Omnibus Hearing (hereinafter defined) or other hearing date, as ordered by the Court at which the Court will consider the Filing (the "Applicable Hearing Date"). Nothing shall prejudice (i) the rights of any party in interest to move the Court to further limit or expand notice of such matters and proceedings upon a showing of good cause, including, but not limited to, the right to file a motion seeking emergency ex parte consideration or consideration upon shortened time; or (ii) the rights of any party to seek an enlargement or reduction of a time period under Bankruptcy Rule 9006(b) or (c).

9. All Notice Requests, whether now filed or filed in the future, for automatic receipt of copies of Filings, Responses, Adversary Pleadings and other documents or writings filed in these cases and any adversary proceeding will be denied except as set forth herein.

10. Parties who file notices of appearance and who desire to be added to the Master Service List should make a written request to that effect to the Debtors. In the written request, the requesting party shall advise the Debtors of the party's interest in the bankruptcy cases and why cause exists for the party's inclusion on the Master Service List. The Debtors shall have twenty (20) business days from receipt of such a request to consider such a request. If the Debtors decline the request or fail

to respond to the same within such 20-day period, the requesting party may then move the Court in accordance with the Notice Procedures, for good cause shown, to be added to the Master Service List.

11. On the last day of each calendar month, or as soon thereafter as is practicable, a copy of this Order, as it may be modified or amended from time to time, shall be served by the Debtors on each party (the "2002 List Parties") that filed a notice of appearance or request for notice in these eases during the preceding month,

12. In the event that a Filing is a motion or application for relief, the objection deadline shall be (a) no later than the seventh (7") calendar date before the Applicable Hearing Date if the Filing is served at least twenty (20) days prior to the Applicable Hearing Date; (b) no later than, the third (3'd) calendar date before the Applicable Hearing Date if the Filing is served less than twenty (20) but at least ten (10) days prior to the Applicable Hearing Date; or (c) otherwise as ordered by the Court. The relief requested in the Filing will be granted without a hearing if no objection is timely filed.

13. Pursuant to Local Rule 402F, the Hearing Date is the date of the "request" to modify the automatic stay under section 362 of the Bankruptcy Code (a "Lift Stay Motion"), In accordance with the deadline and Hearing Date procedures outlined above, and pursuant to section 362(c) of the Bankruptcy Code, unless the Court orders otherwise for good cause shown, if a Lift Stay Motion is filed more than fourteen (14) days before the next scheduled Omnibus Hearing Date, the preliminary hearing/"request" with respect to such Motion shall be such Omnibus Hearing Date. The preliminary hearing/"request" with respect to any Lift Stay Motion filed less than fourteen (14) days before the next scheduled Omnibus Hearing Date shall be the Omnibus Hearing

Date following the next Omnibus Hearing Date. Except as specifically set forth herein, all other procedures for Lift Stay Motions shall otherwise conform to the Local Rules and the Bankruptcy Rules.

14. All persons on the Master Service List shall be served with Filings by overnight mail. All objections, responses or statements in support of Filings as well as any replies thereto (collectively Responses") need only be served on counsel who served such Filings and the parties described in (a) through (e) of paragraph 4 above, provided that all such Responses shall be served so as to be actually received by such parties by the applicable objection deadline.

15. If any person makes any Filing in contravention of the Omnibus Hearing Date process by, among other things, setting a hearing on such Filing for a date and time other than an Omnibus Hearing Date without an order from this Court authorizing such hearing for cause, the Debtors shall forward a copy of the Procedures Order to such person within three (3) business days after receipt. If such Filing is filed at least twenty (20) days prior to the next Omnibus Hearing Date, then the hearing with respect to such Filing shall be deemed to be on such Omnibus Hearing Date, If such Filing is filed less than twenty (20) days prior to the next Omnibus Hearing Date, then the hearing with respect to such Filing shall be the next Omnibus Hearing Date thereafter.

C. Official Copy Service

16. Landmark Document Services, 308 West Randolph, Suite 500, Chicago, IL 60606, tel: (312) 845-1000, fax: (312) 726-9027 is designated the Official Copy Service. Any entity, including the Debtors, submitting any Filing, Response, Adversary Pleadings or other notices or documents to the Court shall also, on the day such document

is submitted with the Court, provide one copy thereof to the Official Copy Service. The Official Copy Service shall monitor the docket in these cases and coordinate with Debtors' counsel to ensure that they have copies of all documents filed in the Debtors' cases.

17. The Official Copy Service will maintain (or have access to) a complete set of all documents filed in these cases henceforth. Upon request of any person, the official Copy Service will supply a copy of any designnated document, at a cost to be paid by the person requesting it at the prevailing fee being charged by the Official Copy Service. Any party that desires copies of every document filed in these eases may obtain such documents at its own expense by arrangement with the Official Copy Service.

18. The Court may conduct case status conferences pursuant to 11 U.S.C. § 105 to review these matters from time to time with representatives of the Debtors, any statutory committees, the United States Trustee, and the Clerk of the Bankruptcy Court. Any statutory committees shall have five (5) days from its formation to provide comments to this order. Any dispute shall be resolved by the Court on notice.

Dated: Chicago, Illinois

January 25, 2002

/s/ SUSAN PIERSON SONDERBY
CHIEF JUDGE SUSAN PIERSON SONDERBY
UNITED STATES BANKRUPTCY JUDGE

APPENDIX F

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

Chapter 11
Case No. 02-___ ( )

In re: KMART CORPORATION, a Michigan Corporation,
Debtor.

CONSOLIDATED LIST OF CREDITORS HOLDING 50 LASGEST UNSECURED CLAIMS

Following is a consolidated list of creditors holding the 50 largest unsecured claims, as of approximately January 18, 2002. The list has been prepared on a consolidated basis, based upon the books and records of the debtor and certain affiliated entities that have contemporaneously commenced chapter 11 cases in this Court (collectively, the "Debtors"). The Debtors believe that this list is representative of the 50 largest creditors in each of the affiliated cases. The information presented in the list shall not constitute an admission by, nor is it binding on, the Debtors.[1]

The list is prepared in accordance with Fed. R. Bankr. P. 1007(d) for filing in this chapter 11 case. The list does not include (1) persons who come within the definition of "insider" set forth in 11 U.S.C. § 101 or (2) secured creditors

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[1] The Debtors will file schedules of assets and liabilities (the "Schedules") in accordance with 11 U.S.C. § 521 and Fed. R. Bankr. P. 1007. The information contained in the Schedules may differ from the information set forth below.

unless the value of the collateral is such that the unsecured deficiency places the creditor among the folders of the 50 largest unsecured claims.[2]

(1) NAME OF CREDITOR AND COMPLETE MAILING ADRESS INCLUDING ZIP CODE	(2) NAME, TELEPHONE NUMBER AND COMPLETE MAILING ADDRESS INCLUDING ZIP CODE, OF EMPLOYEE, AGENT, DEPARTMENT OF CREDOTIR FAMILIAR WITH CLAIM	(3) NATURE OF CLAIM (trade debt, bank loan, government contract, etc.)	(4) C U D S'	(5) AMOUNT OF CLAIM (If secured also state value of security)
Bank of New York Trustee as trustee for 8⅛% Notes due December 1, 2004; 12½ Debentures due March 1, 2005; 9.375% Notes due February 1, 2006; 8⅛ Notes due December 1, 2006; 9⅞ Notes due June 15, 2008; 7¾% Debentures due October 1, 2012; 8¼% Notes due January 1, 2002; 8⅜% Debentures due July 1, 2022; 7.95% Debentures due February 1, 2023; and Medium Term Notes Series A, B, C, and D.	Bank of New York Trustee 5 Penn Plaza New York, NY 10119 Attn: Paul Schmazel Phone: 212-896-7172 Fax: 212-896-7294	Notes		$2,377,532,000
BankBoston, N.A.	BankBoston, N.A. 100 Federal Street Boston, MA 02110 Attn. Kathleen Domock Phone: 617-434-3830 Fax: 617-434-6685	Loan		$119,910,000

[2] The Debtors have not yet identified which of the 50 largest unsecured claims, if any, are contingent, unliquidated, disputed and/or subject to setoff. The Debtors reserve the right to identify any of the 50 largest unsecured claims in their Schedules as contingent, unliquidated, disputed and/or subject to setoff, as appropriate.

Chase II	Chase II c/o Chase Manhattan Bank 1 Chase Manhattan Plaza New York, NY 10081 Attn: Barry Bergman/ Chase II Phone: 212-270-0203 Fax: 212-270-5646	Loan		$117,775,000
Bank of New York	Bank of New York One Wall Street 8th Floor New York, NY 10286 Attn: William Barnum Phone: 212-635-1019 Fax: 212-635-1483	Loan		$104,470,000
Credit Suisse First Boston	Credit Suisse First Boston 11 Madison Avenue 10th Floor New York, NY 10010 Attn: Kristin Lepri/ Credit Suisse First Boston Phone: 212-325-9058 Fax: 212-325-8309	Loan		$83,198,000
First Union National Bank	First Union National Bank One South Penn Square 12th Floor Widener Building Philadelphia, PA 19107 Attn: Margaret J. Gibbons/ First Union National Bank Phone: 267-321-6613 Fax: 267-321-6700	Loan		$81,884,000
Fleming Companies	Fleming Companies 1945 Lakepointe Dr. PO Box 29913 Lewisville, TX 75029 Attn: Bill Marquard Phone: 972-906-8860 Fax: 972-906-8424	Trade		$75,820,923
John Hancock Life Insurance Co.	John Hancock Life Insurance Co. 200 Clarandon St. Boston, MA 02116 Attn: Roger G. Nastou Phone: 617-572-6000 Fax: 617-572-1605	Notes		$72,674,000
Bank One, NA	Bank One, NA 1 Bank One Plaza Suite ILI-0086 Chicago, IL 60670 Attn: Debora K, Oberling/ Bank One, NA Phone: 312-732-4644 Fax: 312-336-4380	Loan		$65,704,000

Handleman Co.	Handleman Co. 500 Kirts Blvd. Troy, MI 48084 Attn: Steve Strome Phone: 248-362-4400 Fax: 248-362-3615	Trade		$63,679,560
Buena Vista Home Video	Buena Vista Home Video 139 Vista Dr. Cannonsburg, PA 15317 Attn: Jim Davis Phone: 724-746-5050	Trade		$56,275,198
Comerica Bank	Comerica Bank 500 Woodward Avenue P.O. Box 75000 MC 3268 Detroit, MI 48275 Attn: Jennifer Pugliano/ Comerica Bank Phone: 31'3-222-9644 Fax: 313-222-9514	Loan		$53,631,000
Bank of America	Bank of America Jon Barnes 100 N. Tryon Street 12th Floor NIC-007-12-08 Charlotte, NC 28255 Attn: Jon Barnes/ Bank of America Phone: 704-387-4366 Fax: 704-409-0768	Loan		$44,925,000
Nonendo of America Inc.	Nontendo of America Inc 4820 15th Ave., NE Redmond, WA 98052 Attn: Randy Peretzman Phone: 425-861-2059 Fax: 425-882-3585	Trade		$44,913,692
Mattel Toys	Mattel Toys 501 Meacham Blvd. Fort Worth, TX 76106 Attn: Tom Bonge Phone: 310-252-6271 Fax: 817-302-3391	Trade		$44,120,598
Key Bank National Association	Key Bank National Association 127 Public Square 6th Floor Cleveland, OH 44114-1306 Attn: J T Taylor/ Key Bank National Association Phone: 216-689-3589 Fax: 216-689-4981	Loan		$38,930,000

Mellon Bank, N.A.	Mellon Bank, N.A. One Mellon Bank Center Room 4530 Pittsburgh, PA 15258-0001 Attn: Louis Flori/ Mellon Bank, N.A. Phone: 412-234-7298 Fax: 412-236-1914	Loan		$38,930,000
Wells Fargo Bank	Wells Fargo Bank 230 West Monroe Suite 2900 Chicago, IL 60606 Attn: Pete Martinets/ Wells Fargo Bank Phone: 312-845-8605 Fax: 312-553-4783	Loan		$38,930,000
Prudential Securities Credit Corp.	Prudential Securities Credit Corp. One New York Plaza 16th Floor New York, NY 10292-2016 Attn: Jeffrey K. French/ Prudential Securities Credit Corp. Phone: 212-778-1540 Fax: 212-778-2535	Loan		$37,205,000
Sumitomo Mitsui Banking Corporation	Sumitomo Mitsui Banking Corporation 233 South Wacker Drive Suite 4010 Chicago, IL 60606 Attn: John Kemper/ Sumitomo Mitsui Banking Corporation Phone: 312-876-7797 Fax: 312-876-6436	Loan		$37,205,000
Teachers Insurance & Annuity Association-CREF	Teachers Insurance & Annuity Association-CREF 730 3rd Ave., Flr. 26 New York, NY 10017 Attn: Michael O'Kane Phone: 212-490-9000 Fax: 212-916-6690	Notes		$36,158,000
Mizuho H[illegible]g, Inc.	Mizuho Holding Inc. Marunouchi Center Bldg. 6-1 Marunouchi, 1-Chome Chiyoda-ku, Tokyo 100-8240 Japan Phone: 81-3-224-1111 Fax: 81-3-3215-4616	Loan		$34,577,000

Twentieth Century Fox Home Entertainment	Twentieth Century Fox Home Entertainment P.O. Box 900 Beverly, Hills, CA 90213 Attn: Mike Weetman Phone: 310-369-1484 Fax: 310-369-4713	Trade		$34,219,742
Bank of Scotland	Bank of Scotland 565 Fifth Avenue 5th Floor New York, NY 10017 Attn: Karim McLean/ Bank of Scotland Phone: 212-350-0816 Fax: 212-682-5720	Loan		$32,852,000
Firstar Bank, N.A.	Firstar Bank, N.A. Retail and Approval Division Mail Code SL-TW-12MP St. Louis, Missouri 63101 Attn: Tom Bayer/ Firstar Bank, N.A. Phone: 314-318-3993 Fax: 314-418-1963	Loan		$31,867,000
Universal Music & Video	Universal Music & Video 10 Universal City, Plaza, Suite 400 Universal City, CA 91608 Attn: Joe Flores Phone: 818-777-4535 Fax: 818-866-1599	Trade		$30,750,077
State of Wisconsin Investment Board-Interned. Govt/ Corp Fd.	State of Wisconsin Investment Board-Interned. Govt/Corp Fd. 121 E. Wilson St. Madison, WI 53703 Attn: Daryl Moe Phone: 608-266-2381 Fax: 608-266-2436	Notes		$30,000,000
Sara Lee Corp	Sara Lee Corp P.O. Box 2760 Winston-Salem, NC 27102 Attn: John Piazza Phone: 910-519-7592 Fax: 336-519-716	Trade		$28,382,838
National City Bank, Columbus	National City Bank, Columbus 155 East Broad Street Columbus, OH 43251-0019 Attn: Jeffrey L. Hawthorne/ Ntl City Colum Phone: 614-463-7298 Fax: 614-463-7191	Loan		$26,774,000

Deutsche Bank AG	Deutsche Bank AG 31 West 53nd Street New York, NY 10019 Attn: Alexander Karow/ Deutsche Bank AG Phone: 212-469-8532 Fax: 212-469-8212	Loan		$26,610,000
Northwestern Mutual Series Fund (Balanced)	Northwestern Mutual Series Fund (Balanced) 720 E. Wisconsin Ave. Milwaukee, WI 53202 Attn: Timothy S. Collins Phone: 414-665-1444 Fax: 414-625-2639	Notes		$25,000,000
Lehman Commercial Paper Inc.	Lehman Commercial Paper Inc. Lehman Brothers Inc. 3 World Financial Center 11th Floor New York, NY 10285 Attn: Michael O'Brien/ Lehman Commercial Paper Inc. Phone: 212-526-0437 Fax: 212-526-7691	Loan		$24,885,000
Metropolitan Life Insurance Co. (New York, NY)	Metropolitan Life Insurance Co. (New York, NY) 1 Madison Ave. New York, NY 10010 Attn: Thomas E. Lenihan Phone: 973-254-3000 Fax: 973-254-3052	Notes		$23,800,000
Vanguard Total Bond Market Index Fund	Vanguard Total Bond Market Index Fund 100 Vanguard Blvd. #M32 Malvern, PA 19355 Attn: Felix B. Lim Phone: 610-669-1000 Fax: 610-669-6246	Notes		$23,500,000
Combine International	Combine International 354 Indusco Court Troy, MI 48083 Attn: Shrik Metha Phone: 248-595-9900 Fax: 248-585-8641	Trade		$22,962,117

Teacher Retirement System of Texas	Teacher Retirement System of Texas 1000 Red River St. Austin, TX 78701 Attn: Herman Martina Phone: 512-397-6400 Fax: 512-370-0568	Notes		$22,890,000
Duracell International	Duracell International Prudential Center 10th Floor Boston, MA 02199 Attn: Don Hoedel Phone: 800-544-0047 Fax: 617-421-7123	Trade		$22,886,461
Michigan Natl Bank of Detroit	Michigan Natl Bank of Detroit 2600 W. Big Beaver Troy, MI 48084 Attn: Jason W. Bierlein/ Michigan Natl Bank of Detroit Phone: 248-822-5702 Fax: 248-637-5003	Loan		$321,518,000
Warner Home Video Div of Time	Warner Home Video Div of Time 4000 Warner Blvd. Burbank, CA 91522 Attn: John Quinn Phone: 818-954-6677 Fax: 818-954-6102	Trade		$21,013,625
Transanmerioca Life Insurance & Annuity Co. S/A	Transamerica Life Insurance & Annuity Co. S/A 433 Edgewood Road NE Cedar Rapids, IA 54499 Attn: Douglas Kolsrud Phone: 319-363-5400 Fax: 319-369-2009	Notes		$20,750,000
Eveready Battery Company Inc.	Eveready Battery Company Inc. 16401 Swingley Ridge Rd. Chesterfield, MO 63017 Attn: Alicia Bryant Phone: 800-323-8177 Fax: 314-733-4001	Trade		$20,002,398
General Electric Lamp	General Electric Lamp 2300 Meijer Drive Troy, MI 48084 AttN; Dave Dobson Phone: 248-280-4885	Trade		$19,860,502

Fidelity High Income Fund	Fidelity High Income Fund 82 Devonshire Boston, MA 02109 Attn: Matthew Conti Phone: 617-563-7000 Fax: 617-570-0276	Notes		$19,572,000
Loomis Sayles Bond Fund	Loomis Sayles Bond Fund 1 Financial Center, Flr. 34 Boston, MA 02111 Attn: Daniel J. Fuss Phone: 617-482-2450 Fax: 617-482-2828	Notes		$19,190,000
Principal Life Insurance Co.	Principal Life Insurance Co. 711 High St. Des Moines, IA 50392 Attn: Richard W. Waugh Phone: 515-247-5111 Fax: 515-248-2490	Notes		$19,000,000
Fisher Price Inc Credit Dept	Fisher Price Inc Credit Dept 636 Girard Ave. East Aurora, NY 14052 Attn: Jerry Cleary Phone: 212-620-8369 Fax: 716-687-3476	Trade		$18,477,874
Fidelity Asset Manager Fund (Aggrgtd)	Fidelity Asset Manager Fund (Aggrgtd) 82 Devonshire Boston, MA 02109 Attn: Matthew Conti Phone: 617-563-7000 Fax: 617-570-0276	Notes		$18,350,000
Electronic Arts	Electronic Arts 209 Redwood Shores Parkway Redwood City, CA 94065 Attn: Larry Probst Phone: 650-628-1500 Fax: 650-628-1414	Trade		$18,203,561
New York Life Insurance Co.	New York Life Insurance Co. 51 Madison Ave. New York, NY 10010 Attn: Celia Holtzberg Phone: 212-576-7000 Fax: 212-576-3418	Notes		$18,071,000
Northwestern Mutual Life Insurance Co.	Northwestern Mutual Life Insurance Co. 720 E. Wisconsin Ave. Milwaukee, WI 53202 Attn: Timothy S. Collins Phone: 414-665-1444 Fax: 414-625-2639	Notes		$17,781,000

I, Charles C. Conaway, Chief Executive Officer of Kmart Corporation, declare under penalty of perjury that I have read the foregoing list and that it is true and correct as of January 22, 2002, to the best of my knowledge, information and belief.

Date: January 22, 2002

Signature: /s/ [Illegible]
Title: Chief Executive Officer
Charles C. Conaway

(2) (2) (2)

Nos. 03-1581, 03-1583, 04-181

Supreme Court, U.S.
FILED
OCT 13 2004
OFFICE OF THE CLERK

In The Supreme Court of the United States

KNIGHT-RIDDER, INC.,

Petitioner,

v.

CAPITAL FACTORS, INC., *et al.*,

Respondents.

HANDLEMAN COMPANY,

Petitioner,

v.

CAPITAL FACTORS, INC., *et al.*,

Respondents.

IRVING PULP & PAPER, LIMITED, dba IRVING PAPER,

Petitioner,

v.

CAPITAL FACTORS, INC., *et al.*,

Respondents.

On Petitions For A Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

BRIEF IN OPPOSITION OF CAPITAL FACTORS, INC.

STEVEN B. TOWBIN
Counsel of Record
PETER J. ROBERTS
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COCKLE LAW BRIEF PRINTING CO. (800) 225-6964
OR CALL COLLECT (402) 342-2831

CORPORATE DISCLOSURE STATEMENT PURSUANT TO SUPREME COURT RULE 29.6

Respondent Capital Factors, Inc. ("Capital") hereby represents that (i) Capital Factors Holding, Inc. ("Capital Holding") is Capital's parent company; (ii) Regions Financial Corporation, a publicly held corporation, is Capital Holding's parent company; and (iii) no other publicly held company owns 10 percent or more of Capital's stock.

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BRIEF IN OPPOSITION

This is Capital's consolidated response in opposition to the petitions ("Petitions") of Knight-Ridder, Inc. ("Knight-Ridder"), Handleman Company ("Handleman"), and Irving Pulp & Paper, Limited ("Irving") for a writ of certiorari to review the decision ("Decision") of the U.S. Court of Appeals for the Seventh Circuit ("Seventh Circuit") in *In re Kmart Corp.*, 359 F.3d 866 (7th Cir. 2004). For the reasons set forth below, the Petitions should be denied.

INTRODUCTION

Through the Decision, the Seventh Circuit affirmed the reversal of a "critical-vendors" order in the chapter 11 bankruptcy case of Kmart Corporation ("Kmart"). The critical-vendors order gave Kmart open-ended authority, on the first day of its bankruptcy case, to pay the prepetition debts of certain suppliers it deemed "critical" in the exercise of its unilateral discretion. *Kmart,* 359 F.3d at 868-69. Kmart fully paid the prepetition debts of approximately 2330 suppliers. *Id.* In contrast to those suppliers, which collectively received about $300 million, Kmart's remaining unsecured creditors eventually received about 10¢ on the dollar on account of their claims, mostly in the form of reorganized Kmart stock. *Id.*

Under the authority of the critical-vendors order, Kmart paid in full the prepetition claims of Knight-Ridder, Handleman, and Irving (collectively, the "Petitioners"). However, the district court subsequently reversed the critical-vendors order. Facing potential liability for the recovery of those now-unauthorized payments from Kmart in pending adversary proceedings brought under § 549 of

the Bankruptcy Code,[1] the Petitioners seek this Court's review of the Seventh Circuit's Decision to affirm the reversal of the critical-vendors order.

The Petitions[2] articulate no compelling reason for granting certiorari in accordance with Sup. Ct. R. 10. As described below, they take liberties with the record, distort the Decision, and rely on inapposite authorities. The Petitions should be denied for the following reasons:

- Though Knight-Ridder takes issue with the Seventh Circuit's application of § 363(b) to the critical-vendors order, its Petition fails to demonstrate any inconsistency between the Seventh Circuit's analysis and those of other circuit courts that have applied § 363(b) in different contexts. Moreover, as the Seventh Circuit stated, "[w]e need not decide whether § 363(b)(1) could support payment of some pre-petition debts, because *this* order was unsound no matter how one reads § 363(b)(1)." *Kmart*, 359 F.3d at 872.

- Notwithstanding Handleman's contentions to the contrary, neither the critical-vendors order nor the district court's subsequent reversal of that order was an *in personam* judgment against Handleman. They were *in rem* orders. Handleman's Petition proceeds from a fundamental misunderstanding of the *in rem* nature of bankruptcy jurisdiction, and it ignores the Seventh Circuit's reliance

[1] Unless otherwise indicated, all statutory references relate to the U.S. Bankruptcy Code, 11 U.S.C. §§ 101 *et seq.* (2004).

[2] References to the Petitions of Knight-Ridder, Handleman and Irving are cited as "KP," "HP," and "IP," respectively.

on Fed. R. Bankr. P. 8001 for the rejection of Handleman's due process arguments. Handleman's quarrels with the Seventh Circuit's admonitions and dicta are no grounds for granting certiorari.

- Irving's Petition seeks an advisory opinion on a circuit split over the proper application of the mootness provisions of § 364(e). Regardless of whether the circuits are split, that issue is inapplicable to this case because the bankruptcy court did not authorize the critical-vendors order under § 364. Even if § 364(e) was applicable, no evidence was presented below to sustain a finding that Irving had acted as a "good faith" lender entitled to the protections of § 364(e).

REASONS FOR DENYING THE PETITIONS

I. Notwithstanding Knight-Ridder's Contention To The Contrary, The Seventh Circuit's Analysis Of § 363(b) Was Consistent With *Lionel* And Its Progeny.

Knight-Ridder contends that the Seventh Circuit's analysis of § 363(b) deviated from "the accepted judicial standard of section 363(b) approval." (KP at 2, 6-9.) In support of this contention, Knight-Ridder cites *Comm. of Equity Sec. Holders v. Lionel Corp. (In re Lionel Corp.)*, 722 F.2d 1063 (2d Cir. 1983) and its progeny. (KP at 6-8.)

Contrary to Knight-Ridder's contention, the Decision reflects a comparable analysis and rationale to that of *Lionel*. Like the Decision, *Lionel* instructs bankruptcy courts "to articulate sound business justifications for

[their] decisions," and "to further the diverse interests of the debtor, creditors and equity holders, alike," rather than "blindly follow[ing] the hue and cry of the most vocal special interest groups." *See Lionel*, 722 F.2d at 1066, 1071. Rather than demonstrating the Seventh Circuit's deviation from established standards for appellate review of § 363(b) orders, *Lionel* actually shows the Seventh Circuit's consistency.

In *Lionel*, the U.S. Court of Appeals for the Second Circuit ("Second Circuit") reviewed, and ultimately reversed, a bankruptcy court's order authorizing a chapter 11 debtor to sell its primary asset before a plan of reorganization could be considered. *Id.* at 1065. In confirming the sale, the bankruptcy court made no formal findings of fact; it "simply noted that cause to sell was sufficiently shown by the Creditors' Committee's insistence upon it." *Id.*

Concerned that an overbroad construction of § 363(b) "swallows up Chapter 11's safeguards" such as plan disclosure and voting requirements, the Second Circuit "reject[ed] the view that § 363(b) grants the bankruptcy judge *carte blanche*." *Id.* at 1069. Instead, the Second Circuit instructed bankruptcy judges determining § 363(b) requests to make express findings from the evidence presented before them that there is "some articulated business justification, other than appeasement of major creditors, for using, selling or leasing property out of the ordinary course of business before the bankruptcy judge may order such disposition under section 363(b)." *Id.* at 1070-71. In fashioning its findings, a bankruptcy judge "should consider all salient factors pertaining to the proceeding and, accordingly, act to further the diverse interests of the debtor, creditors and equity holders, alike."

Id. at 1071. Mere creditor appeasement was "insufficient as a matter of fact because it is not a sound business reason and insufficient as a matter of law because it ignores the equity interests required to be weighed and considered under Chapter 11." *Id.*

As Knight-Ridder points out, other circuit courts have adopted the *Lionel* approach to § 363(b). *See, e.g.*, *Stephens Indus., Inc. v. McClung*, 789 F.2d 386, 390 (6th Cir. 1986); *Institutional Creditors of Cont'l Airlines, Inc. v. Cont'l Airlines, Inc. (In re Cont'l Airlines, Inc.)*, 780 F.2d 1223, 1226 (5th Cir. 1986). Though the Seventh Circuit ultimately determined that "[w]e need not decide whether § 363(b)(1) could support payment of some pre-petition debts, because *this* order was unsound no matter how one reads § 363(b)(1)," its approach in the Decision was also similar to that of the Second Circuit in *Lionel*. *Kmart*, 359 F.3d at 872-74. The Seventh Circuit reviewed the "scant record" for evidence that could justify the purported reasons for the critical-vendors order, and, like the Second Circuit in *Lionel,* it did not consider the appeasement of a vocal special interest group to be an appropriate basis for approval under § 363(b). *Id.*

As the Seventh Circuit noted, "[t]he foundation of a critical-vendors order is the belief that vendors not paid for prior deliveries will refuse to make new ones." *Kmart*, 359 F.3d at 872. For that premise to hold true, a showing must be made that "supposedly critical vendors would have ceased deliveries if old debts were left unpaid." *Id.* at 873. However, the bankruptcy court "did not find that any firm would have ceased doing business with Kmart if not paid for pre-petition deliveries, and the scant record would not have supported such a finding had one been made." *Id.* at 874. In other words, neither the debtor nor the bankruptcy

court articulated a valid reason for the entry of the critical-vendors order.[3]

Moreover, the Seventh Circuit found that a critical-vendors order could not stand under § 363(b) unless it is supported by a showing that disfavored creditors are either likely to receive a benefit or will be no worse off from the requested payments. *Id.* at 873-74. The weighing and consideration of disparate interests in the context of a § 363(b) request is consistent with the approach taken in *Lionel*. *Lionel*, 722 F.2d at 1071 ("In fashioning its findings [on a § 363(b) application], a bankruptcy judge must . . . act to further the diverse interests of the debtor, creditors and equityholders, alike."). Since the record provided no such showing, the Seventh Circuit, like the Second Circuit in *Lionel*, could not allow the bankruptcy court's order to stand. *See Kmart*, 359 F.3d at 874.

As *Lionel* and the Decision both instruct, bankruptcy courts should not serve as a rubber stamp of the debtor's business judgment when they are presented with a § 363(b) request. They must insist on an articulation of that judgment and make express findings to that effect from the evidence presented before them. They must also ensure that vocal special interest groups are not unduly swaying the course of the bankruptcy case at the expense of other competing interests.

For the foregoing reasons, Knight-Ridder has failed to show that the Decision deviated from any established

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[3] As the bankruptcy court itself noted, "[m]otions to pay critical trade creditors always present difficult questions for courts. We're seeing more and more of them, and our problem is that we have to stretch to find some authority to do them." (KP at 66a.)

standard of appellate oversight on § 363(b) issues. Its Petition should be denied accordingly.[4]

II. Handleman Ignores The Seventh Circuit's Holding And Focuses Upon Its Dicta.

A. The Handleman Petition reflects a fundamental misunderstanding of the *in rem* nature of the critical-vendors order and the district court's reversal of that order.

The Handleman Petition rests on an erroneous premise – that the reversal of the critical-vendors order was an *in personam* judgment against Handleman. (HP at 12-14.) As the Seventh Circuit concluded, however, the critical-vendors order concerned Kmart and the use of its property, and it created no rights or interests in favor of anyone but Kmart. *See Kmart,* 359 F.3d at 870. Just as the critical-vendors order was not an *in personam* judgment for or against Handleman or any other creditor, neither was its reversal by the district court. Both were exercises of *in*

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[4] Knight-Ridder also contends that the Decision conflicted with this Court's decision in *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 525 (1984). (KP at 8-10.) The *Bildisco* case dealt with the rejection of a collective bargaining agreement under § 365, an issue and a section of the Bankruptcy Code that are not applicable to this case. *See Bildisco*, 465 U.S. at 516. Nevertheless, Knight-Ridder contends that the Decision conflicts with this Court's endorsement of the "policies of flexibility and equity built into Chapter 11 of the Bankruptcy Code." *Id.* at 525. For the same reasons that the Decision is consistent with *Lionel*, as stated above, it is also consistent with this Court's reasoning in *Bildisco* and its corresponding concern that bankruptcy courts balance the "multiple, competing considerations underlying a Chapter 11 reorganization" through a "reasoned finding on the record" why chapter 11 policy will be served by the requested action. *See id.* at 526-27.

rem jurisdiction over Kmart and its property; personal jurisdiction over Handleman is irrelevant.

Bankruptcy courts have exclusive jurisdiction over a debtor's property, wherever located, and over the bankruptcy estate. *See* 28 U.S.C. § 1334(e). Because the exercise of that jurisdiction is premised on the debtor and its estate, and not on the creditors, bankruptcy courts are able to enter binding orders through their *in rem* jurisdiction without the necessity of acquiring *in personam* jurisdiction over any particular creditors. *Tenn. Student Assistance Corp. v. Hood*, 124 S. Ct. 1905, 1911, 1914 (2004) (citing 4A C. WRIGHT & A. MILLER, FEDERAL PRACTICE AND PROCEDURE § 1070 at 280-81 (3d ed. 2002) (noting jurisdiction over the person is irrelevant if the court has jurisdiction over the property)). Indeed, "[a] bankruptcy court's *in rem* jurisdiction permits it to 'determin[e] all claims that anyone, whether named in the action or not, has to the property or thing in question. The proceeding is "one against the world."'" *Id.* at 1911 (quoting 16 J. MOORE, *ET AL.*, MOORE'S FEDERAL PRACTICE § 108.70[1] at 108-106 (3d ed. 2004)); *see also Local Loan v. Hunt*, 292 U.S. 234, 241 (1934) ("generally, proceedings in bankruptcy are in the nature of proceedings *in rem*").

The critical-vendors order was an exercise of the bankruptcy court's *in rem* jurisdiction over Kmart and its property. As such, it was binding on all Kmart creditors, whether or not they received notice or participated in the bankruptcy court's hearing on the matter. Though the critical-vendors order mentioned Handleman, it gave no relief of any sort to Handleman or any other vendor. (*See* HP at 29a, ¶ 9.) Consequently, when Capital appealed from the critical-vendors order, it correctly named Kmart as the only other party to the order. *See* Fed. R. Bankr. P. 8001(a)

(notices of appeal in bankruptcy must name "all parties to the judgment, order, or decree appealed from").

Upon the filing of Capital's notice of appeal, the district court assumed jurisdiction over the critical-vendors order and its subject matter. *See* 28 U.S.C. § 158(a). *See also Griggs v. Provident Consumer Disc. Co.*, 459 U.S. 56, 58 (1982) (the filing of a notice of appeal confers jurisdiction on the appellate court and divests the lower court of its control over those aspects of the case involved in the appeal). Like the bankruptcy court, the district court did not require personal jurisdiction over Handleman because it did not determine any personal claim by or against Handleman. Rather, it reviewed the propriety of the critical-vendors order and its grant of authority to Kmart to use its property for the payment of certain prepetition claims prior to plan confirmation. Since the district court's jurisdiction, like the bankruptcy court's, was "premised on the res, not on the persona," its exercise was nonetheless binding on Handleman and all other Kmart creditors, "whether named in the action or not." *See Hood*, 124 S. Ct. at 1911.[5]

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[5] In a separate adversary proceeding, reorganized Kmart has sought affirmative relief against Handleman to recover the payment that it received under the authority of the critical-vendors order. (*See* HP at 10.) Therefore, in contrast to the critical-vendors order and its subsequent reversal, any judgment in that proceeding *will* require the exercise of personal jurisdiction over Handleman because the judgment will be premised on the persona and not on the res. *Cf. Hood*, 124 S. Ct. at 1911. In the event that reorganized Kmart recovers any funds from Handleman on account of that judgment, Handleman will be entitled to a claim against the Kmart bankruptcy estate to be treated in accordance with Kmart's confirmed chapter 11 plan. *See* 11 U.S.C. § 502(h).

Handleman's primary citations for its jurisdictional argument are inapposite because they involve *in personam* judgments. *See, e.g., Richards v. Jefferson County*, 517 U.S. 793, 798 (1996); *Martin v. Wilks*, 490 U.S. 755, 761-62 (1989); *Helicopteros Nationales De Colombia, S.A. v. Hall*, 466 U.S. 408, 412 (1984). *Richards* and *Martin* certainly emphasize the "principle of general application in Anglo-American jurisprudence that one is not bound by a judgment *in personam* in a litigation in which he is not designated as a party." *Richards*, 517 U.S. at 798; *Martin*, 490 U.S. at 761. However, they also emphasize an exception to that general principle "where a special remedial scheme exists expressly foreclosing successive litigation by nonlitigants *as for example in bankruptcy*. . . . " *Richards*, 517 U.S. at 798-99 (emphasis added); *Martin*, 490 U.S. at 762 n.2 (emphasis added). *See also Ortiz v. Fibreboard Corp.*, 527 U.S. 815, 846 (1999) (acknowledging the same exception). Handleman ignores the bankruptcy exception.

Consequently, Handleman's jurisdictional argument has no merit. No conflict exists between the Decision and this Court's decisions regarding *in personam* judgments because personal jurisdiction is irrelevant in this case. The district court's reversal of the critical-vendors order was an appropriate exercise of *in rem* jurisdiction that is binding on Handleman and all other entities. Handleman's request to be carved out from the binding effect of that reversal is inappropriate and must be denied accordingly.

B. The Seventh Circuit correctly short-circuited Handleman's due process argument because (i) the critical-vendors order granted no rights to Handleman, and (ii) Handleman had no consequent property interest at stake in the district court appeal.

The Handleman Petition misstates the Seventh Circuit's rationale for rejecting Handleman's due process argument. In rejecting Handleman's due process argument, the Seventh Circuit held that (1) Handleman was not a party to the critical-vendors order, (2) neither Handleman nor any other party acquired any rights under the order, and (3) Capital correctly followed Fed. R. Bankr. P. 8001 when it named only Kmart in its notice of appeal from the critical-vendors order. *See Kmart,* 359 F.3d at 870. Instead of addressing the Seventh Circuit's holding, Handleman's Petition focuses upon its dicta,[6] which present nothing for this Court to review. *See Stickel v. United States,* 76 S. Ct. 1067, 1068 (1956). *See also Black v. Cutter Labs.,* 351 U.S. 292, 297 (1956) ("This Court . . . reviews judgments, not statements in opinions.").

Contrary to Handleman's inaccurate contention that the Seventh Circuit "saw no problem with Handleman's Due Process Rights being skipped at the District Court

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[6] Specifically, Handleman complains about the Seventh Circuit's observations that (1) the precedential impact of its Decision has the same practical effect as its preclusive impact, and (2) it permitted Handleman to intervene in the appeal in any event. (HP at 18-22.) Handleman also complains about the Seventh Circuit's admonition that Handleman should have paid more attention to its $49 million stake in the case. (HP at 22-23.) Since these statements could have been deleted from the Decision without seriously impairing the analytical foundation of the Seventh Circuit's holding, they constitute dicta. *See United States v. Crawley,* 837 F.2d 291, 292 (7th Cir. 1988).

stage" (*see* HP at 18), the Seventh Circuit actually found that the critical-vendors order gave no rights to Handleman or any other creditor. *See Kmart,* 359 F.3d at 870. Consequently, Handleman had no due process interest at stake when the district court conducted its appellate review of the critical-vendors order.

The procedural requirements of due process, notice, and an opportunity to be heard apply only to the deprivation of constitutionally protected interests, liberty, and property. The "range of interests protected by procedural due process is not infinite." *Bd. of Regents v. Roth*, 408 U.S. 564, 569-70 (1972) (a college professor with a one-year contract had no constitutionally protected interest requiring due process, notice, and hearing before his contract was not renewed). Handleman acquired no interest from the critical-vendors order that was entitled to due process protection. (*See* HP at 29a, ¶ 9 ("nothing contained herein shall create, nor is it intended to create, any rights in favor of, or enhance the status of any claim held by, any person").[7] Consequently, Handleman's due process argument, like Professor Roth's, was appropriately rejected. *See Roth*, 408 U.S. at 569-70.

Moreover, as the Seventh Circuit noted, Handleman received better notice and a better opportunity to be heard with respect to Kmart's critical-vendors motion than Capital and most of Kmart's other creditors. *Kmart,* 359

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[7] Handleman erroneously contends that both the critical-vendors order and Kmart's underlying motion identified Handleman "as having a 'particularized interest' in the matter." (*See* HP at 7.) Contrary to Handleman's contentions, neither the critical-vendors order nor the underlying motion contain any such language. (*See* HP at 24a-32a; IP at 45a-63a.)

F.3d at 870. *See also Mullane v. Cent. Hanover Bank & Trust Co.*, 339 U.S. 306, 314 (1950) (The right to be heard has worth when "one is informed that the matter is pending and can choose for himself whether to appear or default, acquiesce or contest."). Handleman, however, chose neither to participate as a litigant in the bankruptcy court, file an appearance, intervene pursuant to Fed. R. Bankr. P. 2018, nor seek notice pursuant to the case management order entered in Kmart's bankruptcy case. Kmart, as the movant, and Capital, as the sole objector, were the only parties to the contested matter surrounding Kmart's critical-vendors motion. *See* Fed. R. Bankr. P. 9014. Consequently, Handleman did not become a party to the critical-vendors order, and it therefore was not entitled to notice of Captial's subsequent appeal. *See* Fed. R. Bankr. P. 8001.

The authority relied upon by Handleman to support its due process argument is easily distinguished from this case. Unlike the numerous cases cited by Handleman, the district court's order of reversal did not strip or bar any liens, claims, or other property interests Handleman may have had with respect to Kmart or its estate. *Cf., e.g., Tulsa Prof'l Collection Servs. v. Pope*, 485 U.S. 478, 488-89 (1985) (creditor's claim barred in probate case); *Mennonite Bd. of Missions v. Adams*, 462 U.S. 791, 792-95 (1983) (mortgagee's property interest foreclosed through tax sale); *Armstrong v. Manzo*, 380 U.S. 545, 550 (1965) (deprivation of parental rights); *Mullane*, 339 U.S. at 320 (two types of claims barred by trust accounting proceeding); *City of N.Y v. N.Y, N.H. & H.R. Co.*, 344 U.S. 293, 297 (1953) (involving the loss of a tax lien claim).[8]

[8] Handleman's reliance on *City of N.Y* in support of its due process arguments is also misplaced because that case was decided on statutory rather than constitutional grounds. *See GAC Enters., Inc. v. Medaglia*

(Continued on following page)

Moreover, as stated above, the reversal of the critical-vendors order resolved no personal claim or affirmative relief by or against Handleman. *Cf., e.g., Nelson v. Adams USA, Inc.*, 529 U.S. 460, 463-64 (2000) (involving personal liability for costs and attorneys' fees); *Ortiz*, 527 U.S. at 821 (mandatory class action aggregating damages claims). By reversing the critical-vendors order, the district court merely clarified the bankruptcy court's lack of authority to allow Kmart to pay the prepetition claims of their trade creditors under the doctrine of necessity or § 105(a). (HP at 16a-19a.) It entered no *in personam* relief for or against Handleman or any other creditor. As a result, Handleman's due process argument has no merit, and the Seventh Circuit appropriately rejected the argument.

III. Irving's Petition Seeks An Advisory Opinion On The Scope Of § 364(e).

Irving's Petition proceeds from the mistaken premise that § 364 of the Bankruptcy Code formed a basis for the bankruptcy court's critical-vendors order. Notwithstanding Irving's constant assertions to that effect, however, § 364 formed absolutely no basis for the entry of the order. (*See* IP at 29a-35a.) The plain meaning of the order and the absence of any reference to § 364 in the record refute Irving's assertions. Regardless of whether a circuit split exists on the scope of § 364(e), as Irving asserts in its Petition, the resolution of that split is irrelevant to this case.

(In re Medaglia), 52 F.3d 451, 455-57 (2d Cir. 1995); *Grossie v. Sam (In re Sam)*, 894 F.2d 778, 781 (5th Cir. 1990).

The express purpose of the critical-vendors order was the payment of prepetition trade claims, not the incurrence of postpetition trade credit. Entitled "Order Under 11 U.S.C. § 105(a) Authorizing The Payment Of Prepetition Claims Of Certain Critical Trade Vendors," the critical-vendors order stated that the "Debtors are authorized, but not directed, in the reasonable exercise of their business judgment, to pay all, a portion or none of the prepetition claims" of so-called critical vendors. (IP at 29a-30a.) Though the order instructed Kmart to pursue "customary trade terms" in exchange for critical-vendor payments, its authorized discretion to make those payments was not conditioned upon the receipt of postpetition trade credit. (IP at 31a-33a.)

The sole statutory basis expressed for the critical-vendors order was § 105. (IP at 29a.) The order did not mention § 364. (*Id.*) Moreover, the record shows that (1) Kmart's critical-vendors motion neither raised nor mentioned § 364 (IP at 47a ("[t]he statutory predicates for the relief sought herein are section 105(a) of the Bankruptcy Code")), and (2) neither Kmart nor any other party presented testimony or other evidence at the bankruptcy court's hearing on the critical-vendors motion to establish grounds for relief under § 364.[9] (KP at 44a-75a.) Capital, therefore, had no reason or opportunity to cross-examine witnesses, rebut testimony, or contest any fact or argument

[9] After presenting its critical-vendors motion to the bankruptcy court at the "first-day" hearing of its bankruptcy case, Kmart presented its motion ("DIP Financing Motion") for authority to obtain $2 billion in postpetition financing pursuant to §§ 105, 361, 362, 364(c)(2), and 364(c)(3). Kmart presented evidence and testimony to establish the grounds for relief under § 364 *specific* to the DIP Financing Motion but only *after* the bankruptcy court had entered the critical-vendors order.

relating to § 364 with respect to the critical-vendors motion. As a result, neither the bankruptcy court nor the district court were given any opportunity to rule on any issue under § 364 in connection with the critical-vendors order.

Irving's Petition is based upon a circuit split over the proper application of § 364(e) to bankruptcy financing orders that permit "cross-collateralization." Except for the Decision, however, the decisions that Irving cites in support of its contention involve bankruptcy financing orders that were entered under the auspices of § 364. (*See* IP at 9-12 (comparing (i) *In re Adams Apple, Inc.*, 829 F.2d 1484, 1488 (9th Cir. 1987) and *Unsecured Creditors' Comm. v. First Nat'l Bank & Trust Co. of Escanaba (In re Ellingsen MacLean Oil Co., Inc.)*, 834 F.2d 599, 604 (6th Cir. 1987); (ii) *Shapiro v. Saybrook Mfg. Co. (In re Saybrook Mfg. Co.)*, 963 F.2d 1490, 1493 (11th Cir. 1992); and (iii) *Resolution Trust Corp. v. Swedeland Dev. Group, Inc. (In re Swedeland Dev. Group, Inc.)*, 16 F.3d 552, 562 (3d Cir. 1994)).)

None of the decisions that Irving cites involved the extension of § 364(e) to an order entered under a provision of the Bankruptcy Code other than § 364. *Id.* In fact, the U.S. Court of Appeals for the Ninth Circuit ("Ninth Circuit") later clarified and distinguished its earlier decision in *Adams Apple* by holding that financing orders entered under a section of the Bankruptcy Code other than § 364 are not shielded from appeal by virtue of § 364(e). *See Transamerica Commercial Fin. Corp. v. Citibank, N.A. (In re Sun Runner Marine, Inc.)*, 945 F.2d 1089, 1095 (9th Cir. 1991) (finding *Adams Apple* to be inapplicable because the underlying bankruptcy court order was entered under § 365, not § 364).

Like the Ninth Circuit in *Sun Runner*, the Seventh Circuit correctly concluded that the mootness provisions of § 364(e) did not apply to the critical-vendors order. *See Kmart*, 359 F.3d at 869. Contrary to Irving's contention that the Seventh Circuit "concluded that the protections of section 364(e) do not apply because the bankruptcy court's approval of the [critical-vendors order] was erroneous" (IP at 21), the Seventh Circuit actually and correctly determined that § 364(e) is irrelevant because the critical-vendors order was not a § 364 financing order. *See Kmart*, 359 F.3d at 869. The Seventh Circuit refused to "invent missing language" in the Bankruptcy Code to shelter the critical-vendors order from appeal. *Id.*

Section 364(e) is inapplicable to the critical-vendors order for at least two reasons.[10] First, the plain language of § 364(e) only shelters bankruptcy court authorizations "*under this section* to obtain credit or incur debt, or of a grant under this section of a priority or a lien . . . [or] the validity of any debt so incurred, or any priority or lien so granted. . . ." 11 U.S.C. § 364(e) (emphasis added); *Saybrook*,

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[10] The reasoning of the Seventh Circuit's decision in *In re EDC Holding Co.*, 676 F.2d 945, 948 (7th Cir. 1982) provides an additional reason for the inapplicability of § 364(e) to the critical-vendors order. In *EDC Holding*, the Seventh Circuit held that § 364(e) would not moot an appeal where the underlying credit transaction evidently effected an improper purpose under the Bankruptcy Code. *EDC Holding*, 676 F.2d at 948. The use of § 364 to pay prepetition unsecured claims is improper because such payments (i) are not authorized under the plain terms of § 364, and (ii) are contrary to the fundamental priority scheme of the Code. *See Saybrook*, 963 F.2d at 1494-95. *See also Kham & Nate's Shoes No. 2, Inc. v. First Bank of Whiting*, 908 F.2d 1351, 1356 (7th Cir. 1990) (Section 364 orders "do not allow a creditor to boost the priority of existing loans."). Consequently, § 364(e) does not shield such payments from subsequent appeals. *See Saybrook*, 963 F.2d at 1494-95; *EDC Holding*, 676 F.2d at 948.

963 F.2d at 1493; *Sun Runner*, 945 F.2d at 1095. As explained above, Kmart's critical-vendors motion sought no authority either to incur debt or grant a priority or a lien under § 364; it only sought leave to *pay* prepetition debts under § 105(a). (*See* IP at 45a-46a.) Furthermore, Capital's subsequent appeal did not affect the "validity of any debt" or "any priority . . . granted . . . " to Irving as a result of Kmart's critical-vendors motion because, as the Seventh Circuit noted in its Decision, (1) "*no* creditor acquired rights" in the critical-vendors order (IP at 35a, ¶ 9 ("nothing herein shall create . . . any rights in favor of, or enhance the status of any claim held by, any person")), and (2) critical vendors such as Irving "have been paid in full for post-petition goods and services." *Kmart*, 359 F.3d at 870. Consequently, on its face, § 364(e) cannot apply to the critical-vendors order. *See Saybrook*, 963 F.2d at 1493; *Sun Runner*, 945 F.2d 1095.

Second, § 364(e) only protects the validity of any debt or the priority of any lien granted under § 364 to an "entity that extended such credit in *good faith*. . . . " 11 U.S.C. § 364(e) (emphasis added). Because Kmart's critical-vendors motion was not brought under § 364, however, the critical-vendors order lacked the support of any findings that Kmart, Irving, or any of the other vendors were acting in good faith as § 364(e) requires. *See N.Y. Life Ins. v. Revco D.S., Inc. (In re Revco D.S., Inc.)*, 901 F.2d 1359, 1367 (6th Cir. 1990) (holding that "an implicit finding of 'good faith' in a § 364(e) context is insufficient and that 'good faith' under that section should not be presumed"); *see also In re Abbotts Dairies of Pa., Inc.*, 788 F.2d 143,

148-49 (3d Cir. 1986) (to the same effect in a case under § 363(m)). Irving's good faith cannot be presumed.[11]

Moreover, Irving's good faith is belied to the extent that its insistence on the payment of its prepetition claims violated the automatic stay. *See* 11 U.S.C. § 362. *See also EDC Holding*, 676 F.2d at 948 (a creditor fails to act in good faith if it acts for an improper purpose). If, as Kmart alleged in support of its critical-vendors motion (IP at 57a, ¶ 27) and as Irving appears to confirm in its Petition,[12] the critical vendors were leveraging their refusal to deal with Kmart on a postpetition basis in order to collect their prepetition debts, then those creditors were violating the automatic stay arising from Kmart's bankruptcy filing by virtue of § 362(a). *Sportfame of Ohio, Inc. v. Wilson Sporting Goods Co. (In re Sportfame of Ohio, Inc.)*, 40 B.R. 47, 50 (Bankr. N.D. Ohio 1984) (refusal to ship goods to coerce payment of prepetition debt violates § 362(a)(6)). *Accord Lansdale Family Rests., Inc. v. Weis Food Serv. (In re Lansdale Family Rests., Inc.)*, 977 F.2d 826, 829 (3d Cir. 1992) (application of postpetition payment to prepetition debt violates § 362(a)(3)); *Andrews Univ. v. Merchant (In re Merchant)*, 958 F.2d 738, 741-42 (6th Cir. 1992) (the refusal to issue a transcript until a debtor pays a prepetition debt

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[11] Irving contends that its good faith is not an issue because the record below shows "no indication that Irving extended credit in bad faith." (IP at 22.) However, that contention ignores the fact that the record below contained no findings of good faith because Kmart did not seek the entry of the critical-vendors order pursuant to § 364. Moreover, Irving erroneously implies that it is entitled to a presumption of good faith that must be rebutted by evidence of bad faith.

[12] Irving readily admits that "unpaid vendors often raise their prices on post-petition shipments to recoup pre-petition losses from bankrupt debtors if they have the leverage to do so, and sophisticated debtors, such as Kmart, are aware of this." (IP at 27.)

violates § 362(a)(6)). Thus, either Irving and the other critical vendors were violating the automatic stay and acting in bad faith in leveraging the payment of prepetition debts through the critical-vendors order, or the alleged factual predicate of Kmart's critical-vendors motion was a fabrication. Either way, Irving is not entitled to the protections of § 364(e).

The Irving Petition, at its essence, constitutes a request for an advisory opinion from this Court on the split that exists between the circuits over the application of § 364(e) to bankruptcy financing orders that allow the cross-collateralization of a creditor's prepetition debt. That circuit split is a purely academic question in the context of this case because the critical-vendors order was not entered or authorized under § 364, which means that § 364(e) is inapplicable on its face. Therefore, even if Irving was successful in convincing this Court to resolve the circuit split, the subsequent resolution would not solve Irving's problem. The shelter of § 364(e) would not extend to the § 105 critical-vendors order in any event. *See Sun Runner*, 945 F.2d at 1095.

This Court does not render advisory opinions; it only resolves concrete controversies. *See, e.g., Diamond v. Charles*, 476 U.S. 54, 61-62 (1986); *Ashcroft v. Mattis*, 431 U.S. 171, 172-73 (1977); *Ruth v. Delano*, 338 U.S. 226, 231 (1949). Irving's Petition should be denied accordingly.

CONCLUSION

For the foregoing reasons, the Petitions for a writ of certiorari from this Court to the Seventh Circuit should be denied

Respectfully submitted,

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(3)

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

HANDLEMAN COMPANY,

Petitioner,

v.

CAPITAL FACTORS, INC., KMART CORPORATION, KNIGHT-RIDDER, INC., AND IRVING PULP & PAPER, LTD.

Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

REPLY BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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INTRODUCTION

Capital Factors' Response Brief demonstrates why this Court should grant Handleman's Petition.

Capital Factors acknowledges that the Seventh Circuit's decision stands for the proposition that the reversal of the Critical Vendors Order is "binding on Handleman and all other Kmart creditors whether or not they received notice or participated in the appeal to the district court." Response at 8. This proposition is completely at odds with our legal system's fundamental concepts of jurisdiction and due process. Yet, the Seventh Circuit held that Handleman and the 2,327 other critical vendors who never had notice of the appeal to the district court, or the opportunity to be heard there, were effectively bound by the district court's determination that they should not have received the funds they were paid.

This Court should grant review to correct the pervasive bankruptcy practice - now formally embraced by the Seventh Circuit - that creditors must "accept" the outcome of an appeal to the district court that determines their property interests even where they are not a party to the appeal. App. 6a. Handleman's Petition raises constitutional questions that are critical to the fairness of our judicial system, and Handleman respectfully requests that the Court grant its Petition and address these questions.

ARGUMENT

I. THE DISTRICT COURT HAD NO JURISDICTION OVER HANDLEMAN

Capital Factors claims its appeal to the district court could bind Handleman, even though it was not a party, because the district court had *in rem* jurisdiction. According

to Capital Factors, "[t]he district court's reversal of the critical vendors order was an appropriate exercise of *in rem* jurisdiction that is binding on Handleman and all other entities." Response at 10.[1]

Even if the district court's jurisdiction was *in rem*, its reversal of the Critical Vendors Order did not bind Handleman because it was not a party to the proceeding and was given no notice of it. As this Court emphasized in *Mennonite Bd. of Missions v Adams*, 462 U.S. 791, 796-97 n.3 (1983):

> "The decision in *Mullane* rejected . . . that due process rights may vary depending upon whether actions are *in rem* or *in personam*."

See Tennessee Student Assistance Corp. v. Hood, 124 S. Ct. 1905, 1911 (2004) (even where a bankruptcy proceeding affords *in rem* jurisdiction, "a nonparticipating creditor cannot be subjected to personal liability")[2]; *Shaffer v. Heitner*, 433 U.S. 186, 206 (1977) (due process "rights cannot depend on the classification of an action as *in rem* or *in personam*"). Thus, whatever the basis of the district court's jurisdiction, its reversal of the Critical Vendors Order may not be applied to Handleman, a non-party.

The Seventh Circuit's decision - and the bankruptcy practice at issue here - fly in the face of the "deep-rooted historic tradition that . . . a judgment or decree among parties to a lawsuit resolves issues as among them, but it does not

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[1] The Seventh Circuit never even raised *in rem* jurisdiction as a basis for its decision.

[2] Contrary to Capital Factors' suggestion, *Tennessee Student Assistance Corp.* did not hold that a court with *in rem* jurisdiction may bind nonparties who are not given notice of the proceeding.

conclude the rights of strangers to those proceedings." *Richards v. Jefferson County*, 517 U.S. 793, 798 (1996). Handleman requests the Court to grant its Petition to review this matter.

II. HANDLEMAN'S DUE PROCESS RIGHTS WERE VIOLATED

According to Capital Factors, "Handleman had no due process interest at stake when the district court conducted its appellate review of the critical-vendors order." Response at 12. Capital Factors contends, as did the Seventh Circuit, that Handleman had no property interest at stake because it was not a "party" to the Critical Vendors Order.

Even if Handleman were not a party to the Critical Vendors Order (which Handleman disputes), Capital Factors' appeal undisputedly requested that the district court determine that Handleman should not have received $49 million and that Handleman be divested of these funds. Thus, Handleman, who was in possession of this $49 million at the time of Capital Factors' appeal, had an enormous property interest in defending the legal basis on which it was paid this sum. *Board of Regents of State College v. Roth*, 408 U.S. 564, 571-2 (1972) (property interests extend well beyond ownership of money). Handleman's property interest arose from its possessory interest in the $49 million, and this property interest did not depend on the merits of Handleman's contention that it had the right to keep the money. As this Court explained in *Fuentes v. Shevin*, 407 U.S. 67, 86-87 (1972):

> "[T]heir possessory interest in the goods . . . was sufficient to invoke the protection of the Due Process Clause.

> . . . The right to be heard does not depend upon an advance showing that one will surely prevail at the hearing. . . . It is enough . . . that a significant property interest is at stake, whatever the ultimate outcome of the hearing."

See Mathews v. Eldridge, 424 U.S. 319, 330 (1976) (the "constitutional challenge is entirely collateral to [the] substantive claim of entitlement").

Despite Handleman's property interest in retaining the $49 million, Capital Factors chose not to make Handleman a party to its district court appeal.[3] As a result, Capital Factor's appeal to the district court could not bind Handleman.[4]

This Court's unanimous decision in *Richards v. Jefferson County*, 517 U.S. 793 (1996) makes this point. There, even though an earlier lawsuit had unsuccessfully challenged an ordinance imposing a new tax, this Court held a new litigant had the unfettered right to challenge the same ordinance in a subsequent suit unaffected by the earlier suit because he was not a party to the first proceeding. This Court further held that it violated the new litigant's due

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[3] Capital Factors' failed to give Handleman notice of its appeal as a party even though Handleman was expressly named in the Critical Vendors Order as a recipient of the funds and Capital Factors knew Handleman's identity and contact information.

[4] Fed. R. Bankr. P. 8001 requires only that a notice of appeal be served on the parties to the order that is appealed. If a district court's resolution of a bankruptcy appeal binds only the parties who receive notice under Rule 8001, then Rule 8001's notice requirements comply with due process. If a district court's resolution of an appeal binds nonparties whose property rights are at issue, then the notice requirements of Rule 8001 do not secure the due process rights of these nonparties.

process rights to have the prior decision - even as precedent - applied to him.[5] 517 U.S. at 805.

The circumstances here are indistinguishable. Capital Factors' appeal to the district court challenged the propriety of the Critical Vendors Order. Because Handleman was not a party to that appeal, our system's most basic due process protections[6] require that the reversal of the Critical Vendors Order not apply to Handleman.

Given these circumstances, Handleman requests that this Court grant Handleman's Petition and review the bankruptcy practice by which persons whose property interests are at stake are not given notice of bankruptcy appeals to the district court, but then are supposedly bound by the outcome of those appeals.

CONCLUSION

Handleman requests that the Court: grant *certiorari*; reverse the Seventh Circuit; and hold that the reversal of the Critical Vendors Order did not bind Handleman or the other

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[5] "A state court's freedom to rely on prior precedent in rejecting a litigant's claims does not afford it similar freedom to bind a litigant to a prior judgment to which he was not a party." *Richards,* 517 U.S. at 805.

[6] Capital Factors contends that bankruptcy proceedings are excepted from these fundamental guarantees. However, this Court has expressly stated that bankruptcy proceedings may terminate property interests only if the procedures are "consistent with due process." *Richards*, 517 U.S. at 798. *See City of New York v. NY, NH & H RR Co.*, 344 U.S. 293 (1953) (applying due process protections to bankruptcy proceedings).

2,327 critical vendors who were not parties to Capital Factors' appeal to the district court.

Respectfully submitted,

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